Sharekhan
by BNP PARIBAS

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Castrol India Limited

Volume gush powers Q1

Lubricants	Sharekhan code: CASTROLIND	Result Update

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 128**	
Price Target: **Rs. 150**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

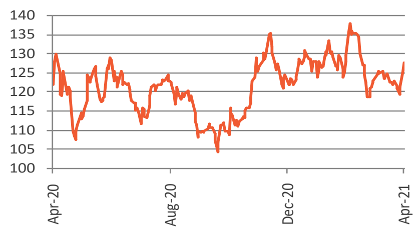
Company details

Market cap:	Rs. 12,637 cr
52-week high/low:	Rs. 140/104
NSE volume: (No of shares)	16.8 lakh
BSE code:	500870
NSE code:	CASTROLIND
Free float: (No of shares)	48.5 cr

Shareholding (%)

Promoters	51.0
FII	11.6
DII	16.7
Others	20.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3	2	10	5
Relative to Sensex	5	-3	-12	-47

Sharekhan Research, Bloomberg

Summary

- Revenues/Operating profit at Rs. 1,139 crore/Rs. 340 crore, rising by 66%/97% y-o-y and sharply beating our estimates by 24%/46% led by a strong beat of 22% in sales volume at 61 million litres and a 447 bps in OPM at 29.9%.
- Volumes surged driven by growth across CV, two-wheeler, four-wheeler and industrial segments as demand was robust in January/February' 21 and there was benefit of pent-up demand. Cost efficiency and price hikes in January led to better margin.
- Q2CY21 volumes to get impacted given lockdowns but may be better on y-o-y given low base of last year (full shutdown in Apr/May'20). Despite concern on near-term volumes, Castrol's alliance with Jio-BP and Ki Mobility would aid volume growth & market share gain.
- Valuation of 13.3x CY22E EPS is attractive (46% discount to historical level) despite decent earnings growth, FCF/dividend yield of 9%/6% and RoE of ~55-60%. We maintain Buy on Castrol with an unchanged PT of Rs. 150.

Castrol India's (Castrol) Q1CY2021 revenue grew strongly by 65.5% y-o-y (up 21.8% q-o-q) to Rs. 1,139 crore, significantly above our estimate of Rs. 915 crore led by: 1) strong beat of 22% in lubricants sales volume at 61 million litres (up 62.2% y-o-y; up 17.3% q-o-q) and 2) better-than-expected gross realisation of Rs. 186.7/litre (up 2% y-o-y; up 3.8% q-o-q) led by price hikes undertaken in January 2021. OPM also improved sharply by 472 bps y-o-y (up 53 bps q-o-q) to 29.9%, beating our estimate of 25.4% on account high operating leverage (reflected in strong revenue growth) and cost efficiencies. However, gross margin declined by 320 bps y-o-y (down 554 bps q-o-q) to 53.9%, below our estimate of 56%. Operating profit/PAT grew sharply by 96.6%/94.6% y-o-y to Rs. 340 crore/Rs. 244 crore and was 46.3%/45.6% above our estimates. Although near-term volumes may get impacted by state specific lockdowns (due to rising COVID-19 cases in India) but Castrol's collaborations with Jio-BP mobility and Ki Mobility are steps in the right direction and would aid volume growth and market share gains. Castrol's valuation of 13.3x CY2022E EPS is attractive given steep discount of 46% to its historical average one-year forward P/E multiple of 24.9x. A strong balance sheet, healthy dividend yield of 5% and a strong RoE of ~55-60% lends comfort to investors. Hence, we maintain a Buy rating on Castrol with an unchanged PT of Rs. 150.

Key positives

- Sharply higher-than-expected lubricant sales volume at 61 million litres (up 62.2% y-o-y; up 17.3% q-o-q).
- Better-than-expected EBITDA margin of 29.9% (up 472bps y-o-y) given cost efficiency and positive operating leverage.
- Strong operational cashflow of Rs. 269 crore (1.1x of Q1CY2021 PAT).

Key negatives

- Lower-than-expected gross margin of 53.9% (down 320 bps y-o-y) despite improvement in realisations.

Our Call

Valuation – Maintain Buy on Castrol with an unchanged PT of Rs. 150: We maintain our CY2021-CY2022 earnings estimate despite sharp beat in volume and margin due to near-term uncertainties on lubricant demand because of recent state specific lockdowns. However, we remain optimistic of a speedy volume recovery (post the easing out of lockdowns) and Castrol's recent alliance with the Jio-BP retail network and Ki Mobility provides long-term volume growth opportunity and scope for market share gain. Castrol's valuation of 13.3x CY2022E EPS is attractive and is at a significant discount of 46% to its historical average one-year forward P/E multiple of 24.9x despite decent earnings growth and a high RoE of 55%. Strong free cashflow (FCF) generation (yield of ~8-9%) and a consistent track record of high dividend payouts (93% in CY2020 and a dividend yield of ~5%) lends comfort to investors. Hence, maintain our Buy rating on Castrol with an unchanged PT of Rs. 150.

Key Risks

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 Rs cr

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	913	948
% YoY growth	2.4	16.8	-27.5	52.3	3.8
Adjusted EPS (Rs.)	7.2	8.4	6.1	9.2	9.6
P/E (x)	17.9	15.3	21.1	13.8	13.3
P/B (x)	10.9	9.3	8.9	7.7	6.9
EV/EBITDA (x)	11.1	10.2	14.0	9.1	8.7
RoNW (%)	64.8	65.3	43.1	59.7	54.6
RoCE (%)	100.6	90.7	56.5	81.8	77.4

Source: Company; Sharekhan estimates

Robust results with sharp 24% and 447bps beat in revenues and OPM

Q1CY2021 revenue grew strongly by 65.5% y-o-y (up 21.8% q-o-q) to Rs. 1,139 crore, significantly above our estimate of Rs. 915 crore led by 1) strong beat of 22% in lubricants sales volumes at 61 million litres (up 62.2% y-o-y; up 17.3% q-o-q) and 2) better-than-expected gross realisation of Rs. 186.7/litre (up 2% y-o-y; up 3.8% q-o-q) led by price hikes undertaken in January 2021. OPM also improved sharply by 472 bps y-o-y (up 53bps q-o-q) to 29.9%, beating our estimate of 25.4% on account of high operating leverage (reflected in strong revenue growth). However, gross margin declined by 320 bps y-o-y (down 554 q-o-q) to 53.9%, below our estimate of 56%. Consequently, operating profit/PAT grew sharply by 96.6%/94.6% y-o-y to Rs. 340 crore/Rs. 244 crore and was 46.3%/45.6% above our estimates.

Q1CY2021 conference call takeaways

- **Business update:** The management indicated that strong volume growth was seen across CV, 2-W, 4-W and industrial lubes as demand was robust in January/February 21 and there was benefit of pent-up demand. The demand from agriculture segment also encouraging. Management highlighted that only a part of the Q1CY2021 growth is sustainable as there was an element of pent-up demand in the overall growth. Castrol India has witnessed continuous market share in the last four quarters and is taking calibrate adjustments to price premium especially for CV segment to gain market share. The recent state specific lockdowns are expected to impact volume in Q2CY2021.
- **High base oil prices – a near-term concern:** The management said that raw material price (base oil prices) has remained high due to supply disruptions. In addition to this, higher logistics costs and recent depreciation of the Indian rupee would also keep raw material cost higher in the near term.
- **Product launches:** The company launched new products namely Castrol GTX SUV for the SUV segment and Power1 Ultimate and Castrol Active Cruise for two-wheelers.
- **Volume mix and lubricant industry size:** Volumes from automotive segment had a share of over 80-85%, while the remaining came from the industrial segment. Personal mobility accounts for 40% of volumes, while the remainder is derived from industrial and commercial vehicle segments. The domestic automobile lubricant market size is estimated at ~1 billion litres (Castrol's market share of ~20%) and that of industrial lubricant is estimated at ~1.5 billion litres.
- **Alliance with Jio-BP and Ki Mobility to fuel volume growth:** Management mentioned that the Jio-BP collaboration continued to see progress and Castrol's products are now available at all the 1,400 Jio-BP fuel stations. Number of Jio-BP sites are likely to increase to 5,000, which will be a major growth contributor. Partnership with Ki Mobility is also expected to provide growth tailwinds as it has substantial network across key cities in India and the collaboration is for 3 years.
- **Electric fluid:** The electric vehicle (EV) space is still in the evolving phase and management is focused to launch various transmission fluids and coolants for EV going forward with support of strong R&D of its parent BP. The company has products like Castrol ON –EV fluids (the range includes e-Transmission Fluids, e-Coolants and e-Greases) to improve electric vehicle performance. The company is already supplying EV fluids to two large EV car manufacturers in India.
- **Focus on branding:** Castrol's products come under the premium category and management has said to maintain its advertisement spends at 3-4% of revenues. However, in the near term, advertisement spending would depend upon the COVID-19 situation in India.
- **Strong cash flows from operations:** The company generated strong cash flow operations of Rs. 269 crore (1.1x of Q1FY2021 PAT). Strong cashflow from operations is led by cost efficiency programs and judicious working capital management.

Results Rs cr

Particulars	Q1CY21	Q1CY20	YoY (%)	Q4CY20	QoQ (%)
Net Sales	1,138.7	688.0	65.5	935.2	21.8
Total Expenditure	798.6	515.0	55.1	677.6	17.9
Operating profit	**340.1**	**173.0**	**96.6**	**257.6**	**32.0**
Adjusted operating profit	**340.1**	**173.0**	**96.6**	**274.4**	**23.9**
Other Income	14.3	19.8	-27.8	15.3	-6.5
Interest	0.6	1.1	-45.5	0.8	-25.0
Depreciation	21.5	22.2	-3.2	22.3	-3.6
Exceptional income/(expense)	0.0	0.0	NA	0.0	NA
PBT	332.3	169.5	96.0	249.8	33.0
Adjusted PBT	332.3	169.5	96.0	266.6	24.6
Tax	88.7	44.3	100.2	62.1	42.8
RPAT	243.6	125.2	94.6	187.7	29.8
Adjusted PAT	**243.6**	**125.2**	**94.6**	**200.3**	**21.6**
Equity Cap (cr)	98.9	98.9		98.9	
Reported EPS (Rs.)	2.5	1.3	94.6	1.9	29.8
Adjusted EPS	2.5	1.3	94.6	2.0	21.6
Margins (%)			bps		bps
Gross margin	53.9	57.0	-320	59.4	-554
Adjusted OPM	29.9	25.1	472	29.3	53
Effective tax rate	26.7	26.1	56	24.9	183
Adjusted NPM	21.4	18.2	320	21.4	-3

Source: Company; Sharekhan Research

Key operating performance Rs cr

Particulars	Q1CY21	Q1CY20	YoY (%)	Q4CY20	QoQ (%)
Volume (million litres)	61.0	37.6	62.2	52.0	17.3
Realisation (Rs. /litre)	186.7	183.0	2.0	179.8	3.8
Gross margin (Rs. /litre)	100.5	104.4	-3.7	106.8	-5.9
EBITDA margin (Rs. /litre)	55.8	46.0	21.2	49.5	12.5

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 the 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.

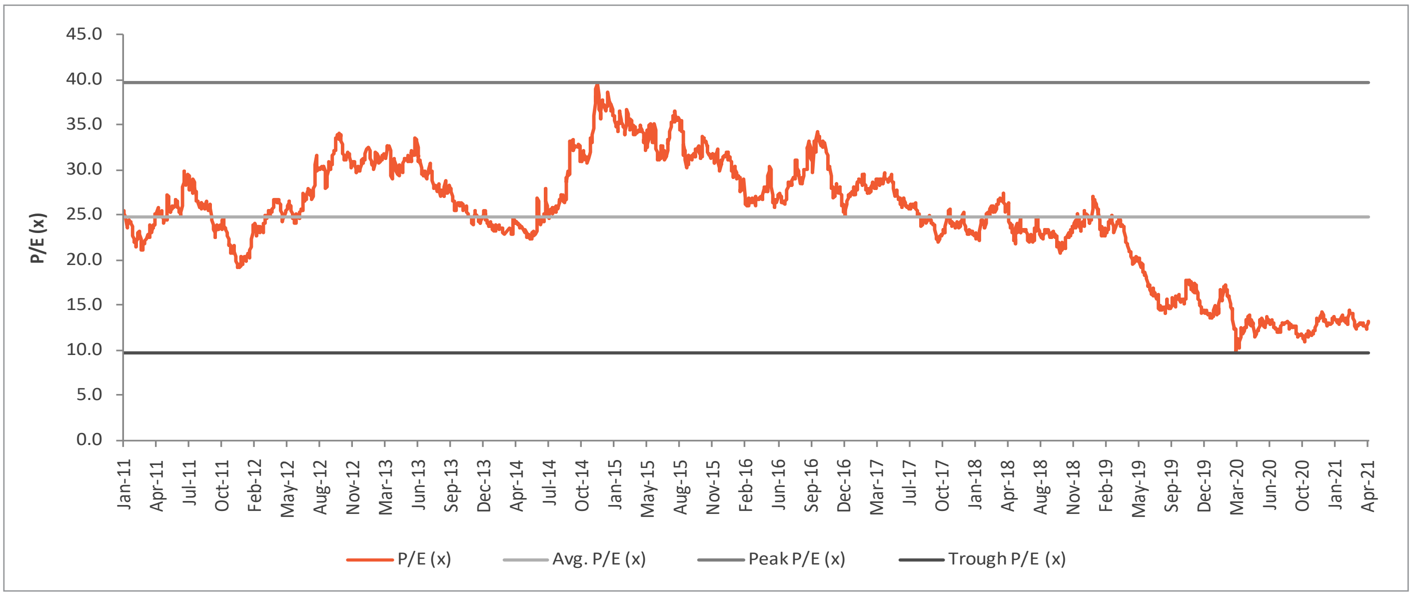
■ **Company outlook - Sharp volume recovery and price hike improves earnings outlook**

Strong demand from personal mobility, potential revival in the CV and industrial segments would help Castrol's lubricants sales volume improve 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, while RoE would remain strong at 56-60%.

■ **Valuation - Maintain Buy on Castrol with an unchanged PT of Rs. 150**

We maintain our CY2021-CY2022 earnings estimate despite sharp beat in volume and margin due to near-term uncertainties on lubricant demand because of recent state specific lockdowns. However, we remain optimistic of a speedy volume recovery (post the easing out of lockdowns) and Castrol's recent alliance with the Jio-BP retail network and Ki Mobility provides long-term volume growth opportunity and scope for market share gain. Castrol's valuation of 13.3x CY2022E EPS is attractive and is at a significant discount of 46% to its historical average one-year forward P/E multiple of 24.9x despite decent earnings growth and a high RoE of 55%. Strong free cashflow (FCF) generation (yield of ~8-9%) and a consistent track record of high dividend payouts (93% in CY2020 and a dividend yield of ~5%) lends comfort to investors. Hence, maintain our Buy rating on Castrol with an unchanged 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 and Ki Mobility 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
Deepesh Baxi	Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	10.6
2	JP Morgan Chase & Company	3.2
3	Vanguard Group Inc/The	1.5
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	Grandeur Peak Global Advisors LLC	0.5
9	Norges Bank	0.4
10	L&T Mutual Fund Trustee Ltd/India	0.4

Source: Bloomberg

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 detoriating 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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