Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Castrol India Ltd

Volume/margins miss mark; valuation attractive

Lubricants	Sharekhan code: CASTROLIND
Reco/View: Buy ⇔	CMP: Rs. 123
	Price Target: Rs. 172 ⇔

↑ Upgrade ⇔ Maintain ↓ Downgrade

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		⇔	

ESG Disclosure Score NEW

ESG RISK RATING Updated Jan 08, 2022	24.32

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 12,173 cr
52-week high/low:	Rs. 155/113
NSE volume: (No of shares)	8.1 lakh
BSE code:	500870
NSE code:	CASTROLIND
Free float: (No of shares)	48.5 cr

Shareholding (%)

Promoters	51.0
FII	12.2
DII	16.4
Others	20.5

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.4	-11.7	-12.4	-5.5
Relative to Sensex	4.7	-7.4	-18.6	-18.1

Sharekhan Research, Bloomberg

Summary

- Q4CY21 adjusted PAT of Rs. 189 crore, down 5.9% q-o-q missed our estimates by 9% on lower-than-expected volume/ margins and a slightly higher tax rate.
- Volumes stayed muted, falling 1% y-o-y to 51.5 million litres, while OPM was at flat q-o-q at as price hikes were offset by a rise in base oil prices. Castrol gained a 100 bps market share in the Bazaar segment.
- Ramp-up of Castrol Express Oil Change outlet at Jio-BP retail networks would aid market share gains and volume growth. Focus on allied services such as vehicle servicing and collaboration with 3M for co-branded vehicle care products would diversify the revenue pie. Calibrated price hikes (amid RM cost inflation) would shield margins.
- Valuation of 13x its CY22E EPS is attractive (48% discount to historical level) despite expectation of strong earnings recovery, FCF/dividend yield of 9%/4.5%, and RoE of ~54%. We thus retain a Buy on Castrol with an unchanged PT of Rs. 172.

Castrol India Limited's (Castrol's) Q4CY2021 revenue grew by 16.6% y-o-y to Rs1,091 crore, which was 5% below our estimate due to miss in sales volume at 51.5 million litres (down 1% y-o-y; up 3% q-o-q) and lower-than-expected realisations of Rs. 212/litre (up 17.7% y-o-y; down 1.3% q-o-q). OPM at 24.4% (down 496 bps y-o-y; flat q-o-q) was also below our estimate of 25.2% due to lower operating leverage (opex as a percentage of revenues stood at 25.4% versus estimate of 24.8%). Consequently, operating profit/PAT of Rs. 266 crore/Rs. 189 crore was down 3.1%/5.9% y-o-y and was below our estimate of Rs. 299 crore/Rs. 208 crore on miss in volumes/margins and a slightly higher tax rate.

Key positives

- Improvement in market share by 100 bps in the Bazaar segment to 20% plus level in CY21..

Key negatives

- Lower -than-expected lubricant sales volume at 51.5 million litres (down 1% y-o-y).
- OPM at 24.4% (flat q-o-q) missed our estimate of 25.2%.

Management Commentary

- **Volume and margin outlook:** The lubricant industry is growing in low to mid-single digits annually and company is focusing on increasing its market share (retail bazaar market share increased by 100 bps y-o-y to 20% plus in CY2021). Market share gains and ramp-up of partnership with Jio-BP retail outlets (Castrol Express Oil Change outlet now at 25 Jio-BP outlets) would drive volume growth. The management expects base oil prices to stay volatile in CY22 and expects to protect margins through calibrated price hikes.
- **Focus on growing adjacent businesses:** The company expanded its automobile service network (now at 94 centers in 40 cities) and has also collaborated with 3M for vehicle care products (this has expanded to 10 cities from 3 cities earlier).
- **Update on EVs:** The Company is fully prepared to manage the transition to EVs in all segments like cars and two-wheelers. Castrol has also done technology collaboration with leading two-wheeler EV manufacturers in India.
- **Other updates:** 1) Castrol plans to increase capex by 25% over normal range of Rs80-Rs100 crore to drive growth and 2) Volume mix: 45% from personal mobility, 40% from CV and 10% industrial, 4) strong cash & bank balance of Rs1300 crore 3) Castrol is not considering any equity share buyback.

Revision in estimates – We have fine-tuned our CY22-23 earnings estimate to factor in slightly higher volume growth and CY21 financials.

Our Call

Valuation – Maintain Buy on Castrol with an unchanged PT of Rs. 172: Castrol's alliance with the Jio-BP retail network provides long-term volume growth opportunity and scope for market share gain while focus to diversify revenue stream is also a step in right direction. Valuation of 13x CY22E EPS is attractive and is at a significant discount of 48% to its historical average one-year forward P/E multiple of 25x and the stock offers decent dividend yield of 4-5% while the balance sheet is robust with a cash position of Rs. 1,300 crore (11% of current market capitalisation). Hence, maintain our Buy rating on Castrol with an unchanged PT of Rs. 172.

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	CY20	CY21	CY22E	CY23E
Revenue	2,997	4,192	4,577	4,878
OPM (%)	27.2	25.4	27.3	28.0
Adjusted PAT	600	758	939	1,026
% YoY growth	-27.5	26.4	23.9	9.2
Adjusted EPS (Rs)	6.1	7.7	9.5	10.4
P/E (x)	20.3	16.1	13.0	11.9
P/B (x)	8.6	7.4	6.7	6.0
EV/EBITDA (x)	13.4	10.2	8.4	7.7
RoNW (%)	43.1	49.6	54.1	53.2
RoCE (%)	56.5	67.0	71.9	77.5

Source: Company; Sharekhan estimates

PAT missed estimates on lower-than-expected volume and margin

Q4CY2021 revenue grew by 16.6% y-o-y to Rs1,091 crore, which was 5% below our estimate due to miss in sales volume at 51.5 million litres (down 1% y-o-y; up 3% q-o-q) and lower-than-expected realisations of Rs. 212/litre (up 17.7% y-o-y; down 1.3% q-o-q). OPM at 24.4% (down 496 bps y-o-y; flat q-o-q) was also below our estimate of 25.2% due to lower operating leverage (opex as a percentage of revenues stood at 25.4% versus estimate of 24.8%). Consequently, operating profit/PAT of Rs. 266 crore/Rs. 189 crore was down 3.1%/5.9% y-o-y and was below our estimate of Rs. 299 crore/Rs. 208 crore on miss in volumes/margins and a slightly higher tax rate.

Results Rs cr

Particulars	Q4CY21	Q4CY20	YoY (%)	Q3CY21	QoQ (%)
Revenue	**1090.6**	**935.2**	**16.6**	**1073.2**	**1.6**
Total Expenditure	824.7	677.6	21.7	810.7	1.7
Operating profit	265.9	257.6	3.2	262.5	1.3
Adjusted operating profit	**265.9**	**274.4**	**-3.1**	**262.5**	**1**
Other Income	12.4	15.3	-19.0	8.4	47.6
Interest	0.5	0.8	-37.5	0.6	-16.7
Depreciation	20.9	22.3	-6.3	20.4	2.5
PBT	256.9	249.8	2.8	249.9	2.8
Adjusted PBT	**256.9**	**266.6**	**-3.6**	**249.9**	**2.8**
Tax	68.3	62.1	10.0	64.0	6.7
Reported PAT	188.6	187.7	0.5	185.9	1.5
Adjusted PAT	**188.6**	**200.3**	**-5.9**	**185.9**	**1.5**
Equity Cap (cr)	98.9	98.9		98.9	
Reported EPS (Rs)	1.9	1.9	0.5	1.9	1.5
Adjusted EPS	1.9	2.0	-5.9	1.9	1.5
Margins (%)			**BPS**		**BPS**
Adjusted OPM	24.4	29.3	-496	24.5	-8
Effective tax rate	26.6	24.9	173	25.6	98
Adjusted NPM	17.3	21.4	-413	17.3	-3

Source: Company, Sharekhan Research

Key operating performance

Particulars	Q4CY21	Q4CY20	YoY (%)	Q3CY21	QoQ (%)
Volume (million litres)	51.5	52.0	-1.0	50.0	3.0
Realisation (Rs/ litre)	211.8	179.8	17.7	214.6	-1.3
Gross margin (Rs/ litre)	105.4	106.8	-1.3	106.5	-1.0
EBITDA margin (Rs/ litre)	51.6	49.5	4.2	52.5	-1.7

Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Lubricant demand to grow in low to mid-single digits; expect price hikes given elevated base oil price**

Lubricant demand is expected to grow at low to mid-single digit over the next couple of years led by higher demand from personal mobility space and rival in demand from CVs on account of overall recovery in Indian economy. We believe that large players like Castrol would continue to gain market share given premium products. However, elevated base oil price is a cause of concern for margins and thus we believe that lubricant makers would continue to take price hikes amid an inflation in raw material prices.

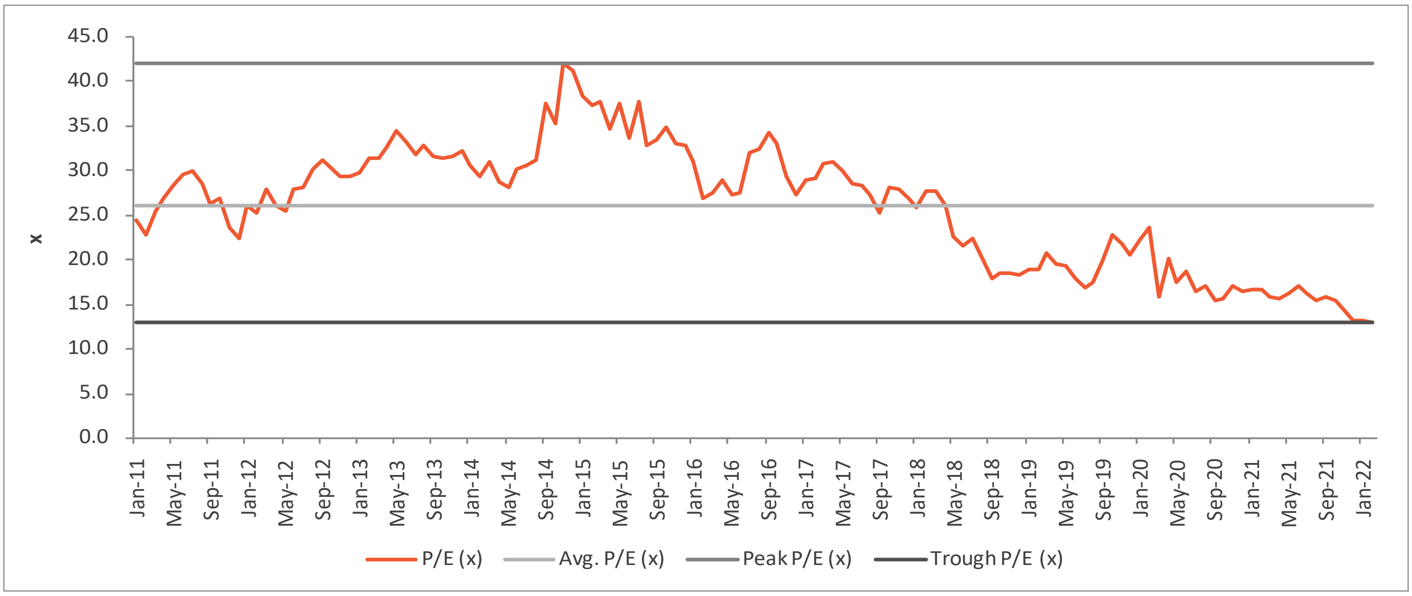
■ **Company outlook - Volume recovery and price hike improves earnings outlook**

Strong demand from personal mobility and potential revival in the CV and industrial segments would help boost Castrol's lubricant sales volumes over CY2021-CY2023E, 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 an 8%, 13% and 16% CAGR over CY2021-CY2023E, while RoE would remain strong at 54%.

■ **Valuation - Maintain Buy on Castrol with an unchanged PT of Rs. 172**

Castrol's alliance with Jio-BP retail network provides long-term volume growth opportunity and scope for market share gain while focus to diversify revenue stream is also a step in right direction. Valuation of 13x CY22E EPS is attractive and is at a significant discount of 48% to its historical average one-year forward P/E multiple of 25x and the stock offers decent dividend yield of 4-5% while the balance sheet is robust with a cash position of Rs. 1,300 crore (11% of current market capitalisation). Hence, maintain our Buy rating on Castrol with an unchanged PT of Rs. 172.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Castrol, a 51% subsidiary of BP Plc, is the largest private sector lubricant player in India. The company caters to the automotive, industrial, and marine and 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 the market leader with ~22% share in the bazaar segment. Castrol operates three manufacturing plants in India and has the largest distribution network of 380 distributors and servicing customers through 110,000 retail sites.

Investment theme

Castrol's recent alliance with the Jio-BP retail network and Ki Mobility provide long-term volume growth opportunity and management's renewed focus to gain share could result in better volume growth in the 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 55% lend comfort to investors. Castrol is trading at a steep discount to its 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	11.3
2	Vanguard Group Inc/The	1.8
3	Abrdn Plc.	1.5
4	Murray International Trust	1.4
5	Aditya Birla Sun Life Trustee Co. Pvt. Ltd	1.2
6	Aditya Birla Sun Life Asset Management Co. Ltd	0.9
7	JPMorgan Chase & Co.	0.6
8	Grandeur Peak Global Advisors LLC	0.4
9	Norges Bank	0.4
10	WisdomTree Investment Inc	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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