Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Castrol India Ltd

## Decent Q1; valuation attractive

| Lubricants | Sharekhan code: CASTROLIND | | |
|---|---|---|---|
| Reco/View: Buy ↔ | CMP: **Rs. 107** | Price Target: **Rs. 135** ↓ | |

↑ Upgrade ↔ Maintain ↓ Downgrade

**Summary**

- Q1CY22 PAT of Rs. 228 crore, rose by 21% q-o-q and beat our estimates by 8% on strong margins and higher other income.
- Volumes stood at 59 million litres (up 14.6% q-o-q and above our estimate of 55 million litres); OPM improved 129 bps q-o-q to 25.7% and beat our estimate led by resilient gross margins of 50.2% (up 38 bps q-o-q despite elevated RM cost).
- The management guided for 24-27% EBITDA margin but hinted that base oil prices remain volatile with an upward trend and thus price hike (already taken price hike of Rs. 12-20/litre) remains key to margin improvement. We cut our CY22-CY23 earnings estimate to factor lower margin assumption.
- Recent under-performance of Castrol versus broader indices largely factors in margin concern and valuation of 11.7x/11x its CY22E/CY23E EPS is attractive. Strong cash balance of Rs. 1,600 crore, dividend yield of 5%, and RoE of ~50% provides comfort to investors. We thus retain a Buy on Castrol with a revised PT of Rs. 135.

**Castrol India Limited's (Castrol's) Q1CY2022 revenue grew by 8.5%/13.3% y-o-y/q-o-q to Rs. 1,236 crore, which was in-line with our estimate as higher than expected lubricant sales volume of 59 million litres (down 3.3% y-o-y; up 14.6% q-o-q) gets offset by lower-than-expected blended realization of Rs. 209/litre (up 12.2% y-o-y; down 1.1% q-o-q) as the benefit of Rs. 12-20/litre price would be visible in Q2CY22. Gross margins remained strong at 50.2%, up 38 bps q-o-q and 317bps above our estimate despite elevated raw material cost environment and thus OPM improved by 129 bps q-o-q (down 420 bps y-o-y) to 25.7%, which was 210 bps above our estimate of 23.6%. Consequently, operating profit/PAT of Rs. 317 crore/Rs. 228 crore, up 19.3%/21.1 q-o-q was 8.8%/8.2% above our estimate of Rs. 292 crore/Rs. 211 crore on account of margin beat, higher other income partially offset by higher tax rate.**

### Key positives

- Higher-than-expected lubricant sales volume at 59 million litres (down only 3.3% y-o-y; up 14.6% q-o-q)
- Sharp beat of 210 bps in OPM at 25.7% (up 129 bps q-o-q).

### Key negatives

- Lower-than-expected blended realisation of Rs. 209/litre (down 1.1% q-o-q).

### Management Commentary

- The management is focused to increase market share and guided for EBITDA margin of 24-27%.
- Strategic investment opportunities in automobile service network and vehicle care products.
- Fully prepared for transition to EVs in all segments and have partnership with 50% of global EV OEMs.
- Strong cash & bank balance of Rs. 1,600 crore and negative working capital.

**Revision in estimates –** We have lowered our CY22-23 earnings estimate to factor in lower margin assumption.

### Our Call

**Valuation – Maintain Buy on Castrol with a revised PT of Rs. 135:** 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 the right direction. Valuation of 11.7x/11.1 CY22E/CY23E EPS is attractive and is at a significant discount of 53% 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. 1,600 crore (15% of current market capitalisation). Hence, maintain a Buy rating on Castrol with a revised PT of Rs. 135.

### 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 | 26.3 | 26.1 |
| Adjusted PAT | 600 | 758 | 906 | 957 |
| % YoY growth | -27.5 | 26.4 | 19.5 | 5.5 |
| Adjusted EPS (Rs) | 6.1 | 7.7 | 9.2 | 9.7 |
| P/E (x) | 17.6 | 14.0 | 11.7 | 11.1 |
| P/B (x) | 7.5 | 6.4 | 5.8 | 5.3 |
| EV/EBITDA (x) | 11.4 | 8.7 | 7.3 | 7.0 |
| RoNW (%) | 43.1 | 49.6 | 52.3 | 50.0 |
| RoCE (%) | 56.5 | 67.0 | 69.5 | 72.7 |

*Source: Company; Sharekhan estimates*

### 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** 23.51

Updated Apr 08, 2022

**Medium Risk**

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

*Source: Morningstar*

### Company details

| | |
|---|---|
| Market cap: | Rs. 10,567 cr |
| 52-week high/low: | Rs. 155/99 |
| NSE volume: (No of shares) | 10.0 lakh |
| BSE code: | 500870 |
| NSE code: | CASTROLIND |
| Free float: (No of shares) | 48.5 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 51.0 |
| FII | 11.1 |
| DII | 16.0 |
| Others | 21.9 |

### Price chart


### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 2 | -14 | -22 | -14 |
| Relative to Sensex | 10 | -11 | -14 | -28 |

*Sharekhan Research, Bloomberg*

**PAT beat estimates on better-than-expected margin and higher other income:** Q1CY2022 revenue grew by 8.5% y-o-y to Rs. 1,236 crore, which was in-line with our estimate of Rs. 1,238 crore as volume beat at 59 million tonnes (down 3.3% y-o-y; up 14.6% q-o-q and 7% above our estimate) was offset by lower-than-expected blended realization at Rs. 209/litre (up 12.2% y-o-y; down 1.1% q-o-q and 7% below our estimate). Gross margin remained strong at 50.2%, up 38 bps q-o-q and 317bps above our estimate) despite elevated raw material cost environment. Thus, OPM improved by 129 bps q-o-q (down 420 bps y-o-y) to 25.7%, which was 210 bps above our estimate of 23.6%. Consequently, operating profit/PAT at Rs. 317 crore/Rs. 228 crore, up 19.3%/21.1 q-o-q was 8.8%/8.2% above our estimate of Rs. 292 crore/Rs. 211 crore on account of margin beat, higher other income partially offset by higher tax rate.

## Q1CY22 conference call highlights

- **Volume and margin outlook:** Demand for lubricants to sustain for the next decade and focus is to increase market share by leveraging Jio-BP partnership. The management expects base oil prices to stay volatile in CY22 and expects to protect margins through calibrated price hikes. Company has taken Rs. 12-20/litre price hikes in this quarter which will get 100% reflected in 1-3 months. Management guided EBITDA margin to be at 24-27% going forward.
- **Focus on strategic investment to tap growth opportunities:** The company is expanding its automobile service network (now at 116 centers in 50 cities) and has also collaborated with 3M for vehicle care products (this has expanded to 10 cities from 3 cities earlier). Company plans to expand into the Tier-II & rural areas for its lubricant business to drive growth.
- **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. It has entered into partnerships with 50% of EV OEMs globally to introduce EV fluids. It has also collaborated with Chinese Companies in the EV space.
- **Other updates:** 1) Volume mix: Sold 59 million litres in Q1CY22 with 43% from personal mobility, 40% from CV and rest from the industrial segment and 2) Strong cash & bank balance of Rs. 1,600 crore and company also has a negative working capital.

**Results** Rs cr

| Particulars | Q1CY22 | Q1CY21 | YoY (%) | Q4CY21 | QoQ (%) |
|---|---|---|---|---|---|
| **Revenue** | **1235.7** | **1,138.7** | **8.5** | **1090.6** | **13.3** |
| Total Expenditure | 918.5 | 798.6 | 15.0 | 824.7 | 11.4 |
| **Operating profit** | **317.2** | **340.1** | **-6.7** | **265.9** | **19.3** |
| Other Income | 15.0 | 14.3 | 4.9 | 12.4 | 21.0 |
| Interest | 0.7 | 0.6 | 16.7 | 0.5 | 40.0 |
| Depreciation | 20.2 | 21.5 | -6.0 | 20.9 | -3.3 |
| **PBT** | **311.3** | **332.3** | **-6.3** | **256.9** | **21.2** |
| Tax | 82.9 | 88.7 | -6.5 | 68.3 | 21.4 |
| Reported PAT | 228.4 | 243.6 | -6.2 | 188.6 | 21.1 |
| Equity Cap (cr) | 98.9 | 98.9 | | 98.9 | |
| Reported EPS (Rs. ) | 2.3 | 2.5 | -6.2 | 1.9 | 21.1 |
| ***Margins (%)*** | | | ***BPS*** | | ***BPS*** |
| OPM | 25.7 | 29.9 | -420 | 24.4 | 129 |
| Effective tax rate | 26.6 | 26.7 | -6 | 26.6 | 4 |
| NPM | 18.5 | 21.4 | -291 | 17.3 | 119 |

*Source: Company, Sharekhan Research*

**Key operating performance**

| Particulars | Q1CY22 | Q1CY21 | YoY (%) | Q4CY21 | QoQ (%) |
|---|---|---|---|---|---|
| Volume (mn litres) | 59.0 | 61.0 | -3.3 | 51.5 | 14.6 |
| Realisation (Rs / litre) | 209.4 | 186.7 | 12.2 | 211.8 | -1.1 |
| Gross margin (Rs / litre) | 105.1 | 100.5 | 4.5 | 105.4 | -0.3 |
| EBITDA margin (Rs / litre) | 53.8 | 55.8 | -3.6 | 51.6 | 4.1 |

*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 prices

Lubricant demand is expected to grow at low to mid-single digits in 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 the Indian economy. We believe that large players like Castrol would continue to gain market share given premium products. However, elevated base oil prices are 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.

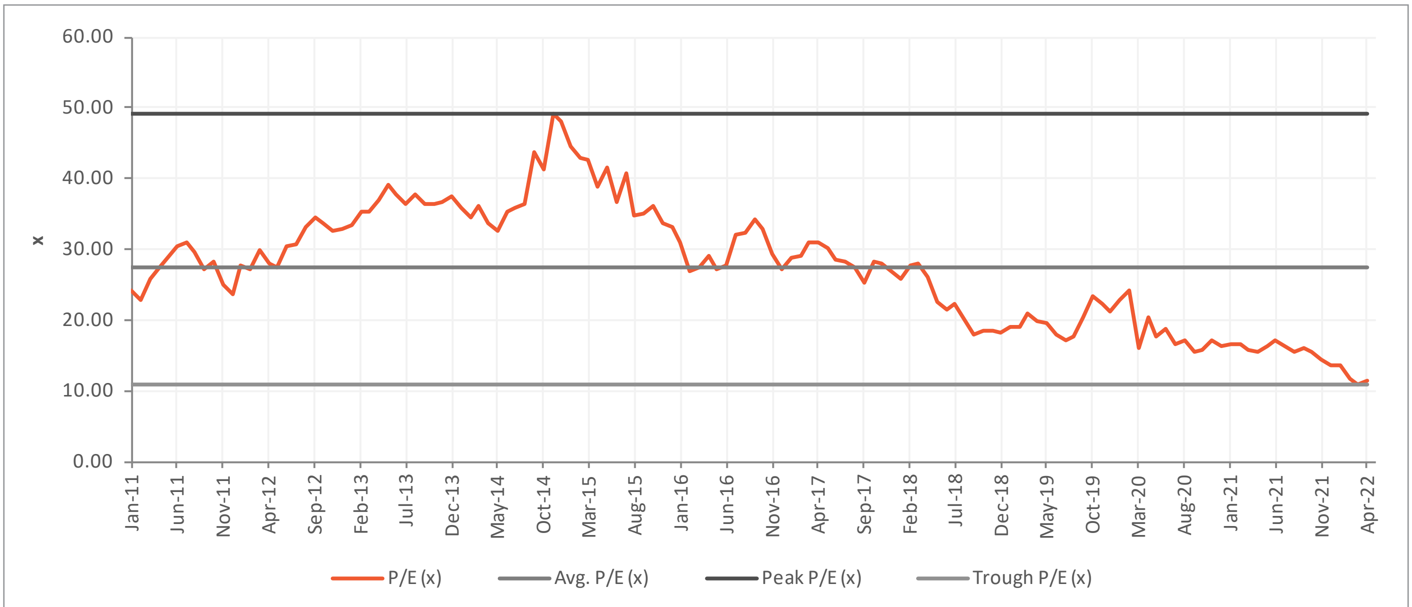
### ■ Company Outlook – Volume recovery and price hike improves earnings outlook

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%, 9% and 12% CAGR over CY2021-CY2023E, while RoE would remain strong at 50%.

### ■ Valuation – Maintain Buy on Castrol with a revised PT of Rs. 135

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 the right direction. Valuation of 11.7x/11.1 CY22E/CY23E EPS is attractive and is at a significant discount of 53% 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. 1,600 crore (15% of current market capitalisation). Hence, maintain a Buy rating on Castrol with a revised PT of Rs. 135.

**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 Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Life Insurance Corp of India | 11.3 |
| 2 | Vanguard Group Inc/The | 1.6 |
| 3 | abrdn plc | 1.5 |
| 4 | MURRY INTERNATIONAL TRUST | 1.4 |
| 5 | Aditya Birla Sun Life Trustee Co Pvt Ltd | 1.2 |
| 6 | Republic of Singapore | 1.2 |
| 7 | Aditya Birla Sun Life Asset Management Co Ltd | 1.1 |
| 8 | JPMorgan Chase & Co | 0.6 |
| 9 | Grandeur Peak Global Advisors LLC | 0.6 |
| 10 | Norges Bank | 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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