Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Castrol India Ltd

Q1 off mark; valuation & dividend yield lend comfort

Lubricants	Sharekhan code: CASTROLIND
Reco/View: Buy ↔	CMP: **Rs. 115**
	Price Target: **Rs. 135** ↔

↑ 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 23.51

Updated Jul 08, 2022

Medium Risk

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

Source: Morningstar

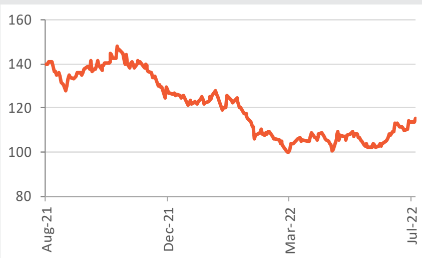
Company details

Market cap:	Rs. 11,383 cr
52-week high/low:	Rs. 150 / 99
NSE volume: (No of shares)	9.9 lakh
BSE code:	500870
NSE code:	CASTROLIND
Free float: (No of shares)	48.5 cr

Shareholding (%)

Promoters	51.0
FII	10.7
DII	16.3
Others	22.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.9	6.2	-6.0	-17.6
Relative to Sensex	1.0	4.1	-4.9	-25.6

Sharekhan Research, Bloomberg

Summary

- Q2CY22 PAT of Rs. 206 crore (down 10% q-o-q) missed estimates due to a slower-than-expected rise in volume/realisation and higher cost. PAT growth of 47% y-o-y was led by low base of Q2CY21 given the impact of COVID-19.
- Volume/blended realisations rose by 24%/12% y-o-y to 56 million litres/Rs. 222/litre was lower than our estimate; thus OPM of 23% also missed estimate by 119 bps and got further affected by 12% q-o-q rise in other expenses.
- Base oil price likely to rise by $100-150/tonne in Q3CY22 before seeing any signs of softness in Q4CY22. We thus expect margins to remain volatile. Parent company BP's plan to invest 50 million pounds in R&D for EV batteries would provide Castrol a strategic edge in India's transition toward EVs.
- We maintain Buy on Castrol India with an unchanged PT of Rs. 135. Valuation of 12x CY23E EPS is attractive and dividend yield of 4-5% and strong cash position lends comfort.

Castrol India Limited's (Castrol's) Q2CY22 performance was weak with 11%/15%/16% miss in revenue/operating profit/PAT at Rs. 1,242 crore/Rs. 286 crore/Rs. 206 crore, up 40%/45%/47% y-o-y. The miss is earnings was on the account of slower-than-expected increase in volume/ blended realisations by 24%/12% y-o-y to 56 million litres and Rs. 222/litre, respectively and a higher-than-expected other expenses (up 12% q-o-q). Thus, OPM at 23% (up 83 bps y-o-y; down 263 bps q-o-q) was 119 bps below our estimate of 24.2%. We highlight here that y-o-y earnings growth was on the low base of last year that was impacted by the COVID-19 second wave and sequential performance was weak with muted revenue (flat q-o-q) and 9.8%/9.7% q-o-q decline in operating profit/PAT.

Key positives

- Strong cash & bank balance of Rs. 1,504 crore as of June 2022.
- Declared interim dividend of Rs. 3/share, which implies 2.5% dividend yield on CMP.

Key negatives

- Miss in blended realisation of Rs. 222/litre (down 7.6% q-o-q).
- Lower-than-expected growth of 24% y-o-y in lubricant sales volume at 56 mn litres.

Management Commentary

- Parent BP to invest 50 million poundsin EV battery R&D center. Access to parent firm's global R&D and EV products would help Castrol in working with EV OEMs.
- Traditional lubricants markets in India to continue to grow till 2035-40 given lower car penetration in India.
- Base oil price expected to further increase by $100-150/tonne in Q3CY22 before seeing a likely correction in Q4CY22. Thus, aim to keep balance between volume and margins. The company undertook two price hikes in H1CY22.
- Revenue mix – PM/CV/Industrial lubricants at 50%/35-40%/10-15%.

Revision in estimates – We have marginally lowered our CY22 earnings estimate to factor H1CY22 results and fine-tuned our CY23 earnings estimates.

Our Call

Valuation – Maintain Buy on Castrol with an unchanged PT of Rs. 135: Castrol's alliance with the Jio-BP retail network provides long-term volume growth opportunity and scope for market share gains, while focus to diversify revenue stream is also a step in the right direction. Moreover, parent BP's focus on EV battery could provide Castrol India an edge (in supply of EV fluids) in India's transition towards EVs. Valuation of 12.8x/11.9x CY22E/CY23E EPS is attractive and is at a significant discount of 49% to its historical average one-year forward P/E multiple of 25x and the stock offers a decent dividend yield of 4-5%, while the balance sheet is robust with a cash position of Rs. 1,504 crore (13% of current market capitalisation). Hence, we maintain a Buy rating on Castrol with an unchanged 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 affect margins.

Valuation Rs cr

Particulars	CY20	CY21	CY22E	CY23E
Revenue	2,997	4,192	4,902	5,248
OPM (%)	27.2	25.4	24.1	24.3
Adjusted PAT	600	758	890	957
% YoY growth	*-27.5*	*26.4*	*17.4*	*7.5*
Adjusted EPS (Rs)	6.1	7.7	9.0	9.7
P/E (x)	19.0	15.0	12.8	11.9
P/B (x)	8.1	6.9	6.3	5.7
EV/EBITDA (x)	12.4	9.5	8.2	7.7
RoNW (%)	43.1	49.6	51.4	50.1
RoCE (%)	56.5	67.0	68.4	72.7

Source: Company; Sharekhan estimates

Q1 PAT below estimate on revenue/margin miss and higher other expenses

Q2CY2022 revenue grew by 39.6% y-o-y to Rs. 1,242 crore, which was below our estimate of Rs. 1,392 crore due to lower-than-expected volume and realisation. The lubricant sales volume stood at 56 million litres (up 24.4% y-o-y; up 8.7% q-o-q) while blended realization declined by 7.6% q-o-q (up 2.2% y-o-y) to Rs. 222/litre. Gross margins remained resilient at 49.5%, down 263 bps q-o-q and 336 bps above our estimate) despite volatile raw material cost environment but OPM of 23% (up 83 bps y-o-y; down 263 bps q-o-q) missed our estimate of 24.2% due to a rise in other expenses (up 12% q-o-q due to a rise in freight/travel and general inflationary pressure). Consequently, operating profit/PAT at Rs. 286 crore/Rs. 206 crore, up 45%/47 y-o-y and was 15%/16% below our estimate of Rs. 337 crore/Rs. 245 crore on account of a miss in volume/margin and higher other expenses partially offset by lower-than-expected effective tax rate of 16.6% (versus assumption of 18%).

Q2CY22 conference call highlights

- **Management guidance:** The management expects growth to be steady in H2CY23. They believe that base oil prices will increase in Q3CY22 by $100-150/tonne but will start seeing some softening in Q4CY22. The company has in the past quarters taken calibrated price hikes to protect margins.
- **Launch of new products:** Castrol launched CRB Plus CI4 for agri-vehicles and GTX Diesel CI4+ variants, upgrading the specifications of the products to offer better protection and performance. It also launched Castrol POWER1 3-in-1 with synthetic technology. The new formula provides excellent acceleration, excellent protection, and smooth rides. Launched Castrol ON in EV fluids which is being supplied to OEMs only at present.
- Focus on strategic investment to tap growth opportunities: The company is expanding its automobile service network (now at 163 centers in more than 90 cities) and has expanded presence of Castrol Express Oil Change outlets in Jio-BP mobility stations across India, bringing the total count to 39.
- **Market share:** Company's current market share is at 21-22% (flat y-o-y) in the automobile aftermarket retail segment and focus is to increase market share by leveraging Jio-BP partnership.
- **Synergies from strategic announcement made by BP:** BP plans to invest upto 50 million pounds n a new global battery research and development center in Britain. This is of strategic importance to Castrol as the new facility would be housed at Castrol's global headquarters in Pangbourne, UK and the technology center is expected to be opened in 2024. This would enable Castrol to be relevant and competitive in the EV future which is beginning to unfold across geographies. Castrol will work with global car manufacturers to co-engineer future battery technology and associated thermal fluids. The center will also develop technologies to enable ultra-fast charging.
- **Negligible contribution from EV segment:** Management said contribution of revenue from EV segment is negligible and that it doesn't see any major change even 5 years down the line.
- **Other updates:** 1) Volume mix: Castrol sold 56 million litres in Q2CY22 with 50% from personal mobility, 35-40% from CV and rest from the industrial segment 2) Sharp increase in other expenses sequentially was due to inflation in travel, freight and insurance cost 3) Cash & bank balance of Rs. 1,504 crore and company also has a negative working capital. 4) Board declared an interim dividend of Rs. 3 per equity share.

Results (Consolidated) Rs cr

Particulars	Q2CY22	Q2CY21	Y-o-Y %	Q1CY22	Q-o-Q %
Revenue	**1241.7**	**889.6**	**39.6**	**1235.7**	**0.5**
Total Expenditure	955.6	692.0	38.1	918.5	4.0
Operating profit	**286.1**	**197.6**	**44.8**	**317.2**	**-9.8**
Other Income	13.7	13.3	2.7	15.0	-8.9
Interest	0.5	0.7	-31.0	0.7	-30.0
Depreciation	19.6	19.9	-1.8	20.2	-3.1
PBT	279.7	190.2	47.0	311.3	-10.1
Tax	73.5	50.2	46.4	82.9	-11.4
Reported PAT	**206.3**	**140.0**	**47.3**	**228.4**	**-9.7**
Equity Cap (cr)	98.9	98.9		98.9	
Reported EPS (Rs.)	2.1	1.4	47.3	2.3	-9.7
Margins(%)			**BPS**		**BPS**
OPM	23.0	22.2	83	25.7	-263
Tax rate	26.3	26.4	-12	26.6	-37
NPM	16.6	15.7	87	18.5	-187

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q2CY22	Q2CY21	Y-o-Y %	Q1CY22	Q-o-Q %
Volume (mn litres)	56.0	45.0	24.4	51.5	8.7
Realisation (Rs. /litre)	221.7	197.7	12.2	239.9	-7.6
Gross margin (Rs. /litre)	109.5	98.8	10.8	133.6	-18.1
EBITDA margin (Rs. /litre)	51.1	43.9	16.4	61.6	-17.0

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 commercial vehicles 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.

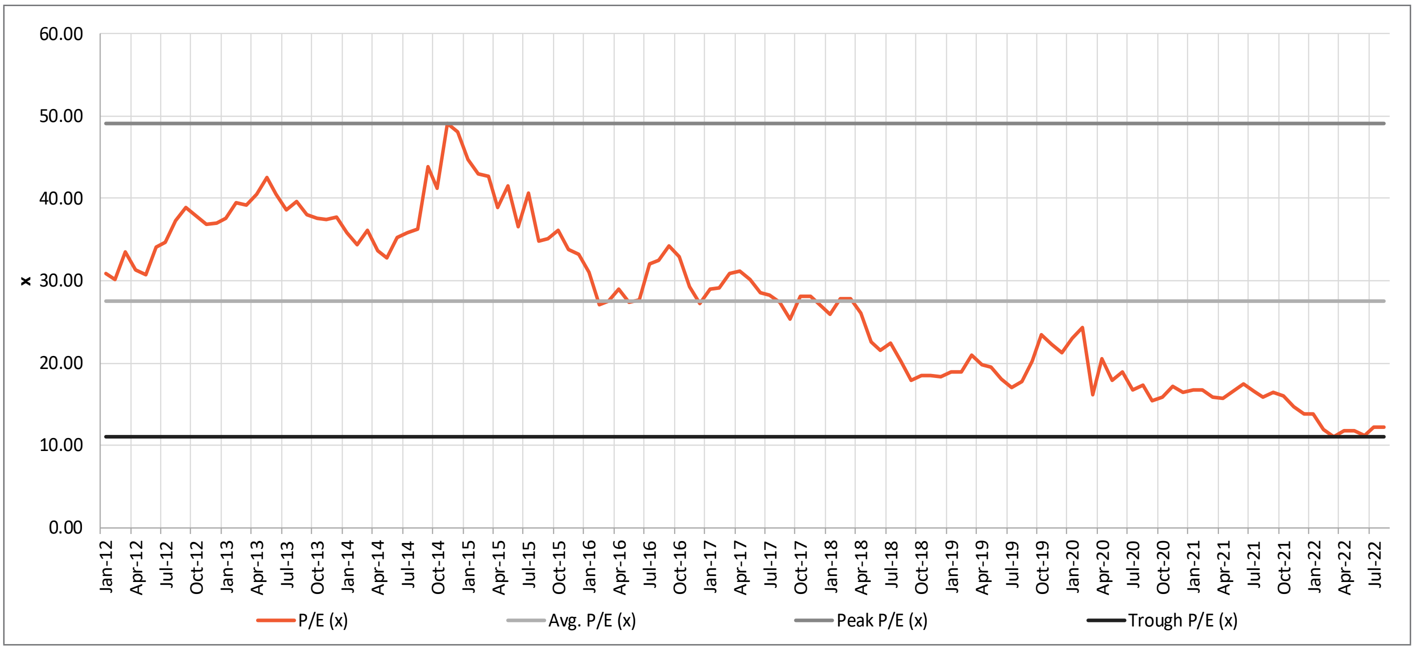
■ Company outlook – Volume recovery and price hike improves earnings outlook

Strong demand from personal mobility and a 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 CAGRs of 12%, 9% and 12%, over CY2021-CY2023E, while RoE would remain strong at 50%.

■ Valuation – Maintain Buy on Castrol with an unchanged PT of Rs. 135

Castrol's alliance with the Jio-BP retail network provides a long-term volume growth opportunity and scope for market share gains, while focus to diversify revenue stream is also a step in the right direction. Moreover, parent BP's focus on EV battery could provide Castrol India an edge (in supply of EV fluids) in India's transition towards EVs. Valuation of 12.8x/11.9x CY22E/CY23E EPS is attractive and is at a significant discount of 49% to its historical average one-year forward P/E multiple of 25x and the stock offers a decent dividend yield of 4-5%, while the balance sheet is robust with a cash position of Rs. 1,504 crore (13% of current market capitalisation). Hence, we maintain a Buy rating on Castrol with an unchanged PT of Rs. 135.

One-year forward P/E (x) band



Source: Company, 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 Corporation of India	11.33
2	Vanguard Group Inc	1.56
3	abrdn plc	1.42
4	MURRAY INTERNATIONAL TRUST	1.42
5	Republic of Singapore	1.19
6	Aditya Birla Sun Life Asset Management Co Ltd	1.10
7	Wisdom Tree Investments Inc	0.40
8	Norges Bank	0.39
9	Dimensional fund advisors LP	0.37
10	Caisse de Depot et Placement du Quebec	0.35

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Priya Sonavane; Tel: 022–61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai–400028, Maharashtra, INDIA, Tel: 022–67502000 / Fax: 022–24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.