Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Castrol India Ltd

Q3 volume disappoints

Lubricants	Sharekhan code: CASTROLIND
Reco/View: Buy ↔	CMP: Rs. 120 / Price Target: Rs. 140 ↑

↑ 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 Oct 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. 11,862 cr
52-week high/low:	Rs. 143/99
NSE volume: (No of shares)	10.6 lakh
BSE code:	500870
NSE code:	CASTROLIND
Free float: (No of shares)	48.5 cr

Shareholding (%)

Promoters	51.0
FII	10.8
DII	16.1
Others	22.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.3	4.2	10.6	-15.2
Relative to Sensex	-0.3	-0.9	3.4	-17.0

Sharekhan Research, Bloomberg

Summary

- Q3CY22 PAT of Rs. 187 crore (down 9% q-o-q) missed estimates primarily due to lower than-expected volumes while per unit margin met expectations led by price hikes.
- Volume performance was weak with 6%/16% y-o-y/q-o-q decline to 47 million litres due to inflationary environment while price hike helped blended realization increase of 11%/7.6% y-o-y/q-o-q to Rs. 239/litre. Thus, per unit EBITDA margin of Rs. 54.7/litre (up 4%/7% y-o-y/q-o-q) was in-line with estimate of Rs. 54.8/litre.
- The company took three price hikes in CY22 to mitigate higher base oil price and strike balance between volume/margin. Management expects inflationary environment and FX pressure to continue in Q4CY22. Castrol has also amended its AOA/MOA so as to focus on future opportunities in auto value chain.
- We maintain Buy on Castrol India with a revised PT of Rs. 140 given inexpensive valuation of 12.6x CY23E EPS, healthy dividend yield of ~5% and strong cash position.

Castrol India Limited's (Castrol's) Q3CY22 results were weak as earnings missed estimate due to substantially lower-than-expected lubricant sales volume at 47 million litres, down 6%/16% y-o-y/q-o-q while per unit EBITDA margin of Rs. 55/litre (up 4.2% y-o-y; up 7.1% q-o-q) was in-line with estimate. Revenue of Rs. 1,121 crore (up 4.7% y-o-y; down 9.7% q-o-q) was below our estimate of Rs. 1204 crore due to 16% miss in volume partially offset by better-than-expected realisation of Rs. 239/litre (up 11.1% y-o-y; up 7.6% q-o-q). OPM declined by 152 bps y-o-y to 22.9%, which was 256 bps below our estimate of 25.5% due to lower-than-expected gross margin of 45.5% (down 415 bps y-o-y; 391 bps q-o-q) on account to steep rise in raw material cost partially offset by lower opex (down 6.5% y-o-y). PAT at Rs. 187 crore (up 0.7% y-o-y; down 9.3% q-o-q) was 16% below our estimate of Rs. 223 crore due to miss in volumes, higher-than-expected tax rate partially offset by higher other income (up 123% y-o-y).

Key positives

- Higher-than-expected realisation of Rs. 239/litre, up 11.1%/7.6% y-o-y/q-o-q.

Key negatives

- Lower-than-expected lubricant sales volume at 47 million litres, down 6% y-o-y.

Management Commentary

- The company undertook three price hikes (in March/June/September) which covered most of input rise on per litre basis. Management expects inflationary environment and FX pressure to continue in Q4CY22.
- Focus to expand new business avenues - Automobile service network now comprises 210 centers across 110 cities in India. Auto service centers to be certified by Castrol but it would own the centers.
- Change in AOA/MOA so as to focus on future opportunities in automobile value chain. Exploring further collaborations with electric vehicle OEMs to help advance electric mobility in India.
- Parent BP plan to invest Euro50 million in EV battery R&D center (expected to become operational by 2024) and provide access to parent's global R&D and EV products would aid in working with EV OEMs.
- Expects lubricant market in India to grow by 4% in CY2023. Demand from car categories to be much higher compared to 2W/CV.
- **Revenue mix –** PM/CV/Industrial lubricants at 50%/30%/20%.

Revision in estimates – We have lowered our CY22-23 earnings estimate to factor 9MCY22 results and have introduced our CY24 earnings estimates.

Our Call

Valuation – Maintain Buy on Castrol with a revised PT of Rs. 140: 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. Moreover, parent BP's focus on EV batteries could provide Castrol India edge (in supply of EV fluids) in India's transition towards EVs. Valuation of 12.6x CY23E EPS is attractive and is at a significant discount of 50% to its historical average one-year forward P/E multiple of 25x and the stock offers decent dividend yield of ~5% while the balance sheet is robust with a cash position of Rs. 1,504 crore (13% of current market capitalisation) as on September 30, 2022. Hence, maintain a Buy rating on Castrol with a revised PT of Rs. 140.

Key Risks

An economic slowdown could lead to lower-than-expected lubricant volumes, whereas a sharp rise in base oil prices could impact margins.

Valuation Rs cr

Particulars	CY21	CY22E	CY23E	CY24E
Revenue	4,192	4,974	5,425	5,754
OPM (%)	25.4	22.6	23.1	23.2
Adjusted PAT	758	847	942	1,072
% YoY growth	*26.4*	*11.7*	*11.2*	*13.8*
Adjusted EPS (Rs)	7.7	8.6	9.5	10.8
P/E (x)	15.7	14.0	12.6	11.1
P/B (x)	7.2	6.6	6.0	5.4
EV/EBITDA (x)	9.9	9.0	8.2	7.7
RoNW (%)	49.6	49.0	49.5	51.1
RoCE (%)	67.0	65.2	71.8	84.8

Source: Company; Sharekhan estimates

Weak Q3 results on lower-than-expected volumes

Q3CY22 results were weak as earnings missed estimate due to substantially lower-than-expected lubricant sales volume at 47 million litres, down 6%/16% y-o-y/q-o-q while per unit EBITDA margin of Rs. 55/litre (up 4.2% y-o-y; up 7.1% q-o-q) was in-line with estimate. Revenue of Rs. 1,121 crore (up 4.7% y-o-y; down 9.7% q-o-q) was below our estimate of Rs. 1204 crore due to 16% miss in volume partially offset by better-than-expected realisation of Rs. 239/litre (up 11.1% y-o-y; up 7.6% q-o-q). OPM declined by 152 bps y-o-y to 22.9%, which was 256 bps below our estimate of 25.5% due to lower-than-expected gross margin of 45.5% (down 415 bps y-o-y; 391 bps q-o-q) on account to steep rise in raw material cost partially offset by lower opex (down 6.5% y-o-y). PAT at Rs. 187 crore (up 0.7% y-o-y; down 9.3% q-o-q) was 16% below our estimate of Rs. 223 crore due to miss in volumes, higher-than-expected tax rate partially offset by higher other income (up 123% y-o-y).

Results Rs cr

Particulars	Q3CY22	Q3CY21	YoY (%)	Q2CY22	QoQ (%)
Revenue	**1121.1**	**1073.2**	**4.5**	**1241.7**	**-9.7**
Total Expenditure	863.9	810.7	6.6	955.6	-9.6
Operating profit	**257.1**	**262.5**	**-2.0**	**286.1**	**-10.1**
Other Income	18.7	8.4	122.7	13.7	36.9
Interest	1.2	0.6	105.0	0.5	151.0
Depreciation	20.8	20.4	1.9	19.6	6.2
PBT	253.8	249.9	1.6	279.7	-9.3
Tax	66.7	64.0	4.2	73.5	-9.3
Reported PAT	**187.2**	**185.9**	**0.7**	**206.3**	**-9.3**
Equity Cap (cr)	98.9	98.9		98.9	
Reported EPS (Rs.)	1.9	1.9	0.7	2.1	-9.3
Margins (%)			**BPS**		**BPS**
OPM	22.9	24.5	-152	23.0	-11
Tax rate	26.3	25.6	65	26.3	0
NPM	16.7	17.3	-63	16.6	8

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q3CY22	Q3CY21	YoY (%)	Q2CY22	QoQ (%)
Volume (million litres)	47.0	50.0	-6.0	56.0	-16.1
Realisation (Rs. /litre)	238.5	214.6	11.1	221.7	7.6
Gross margin (Rs. /litre)	108.4	106.5	1.8	109.5	-1.0
EBITDA margin (Rs. /litre)	54.7	52.5	4.2	51.1	7.1

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.

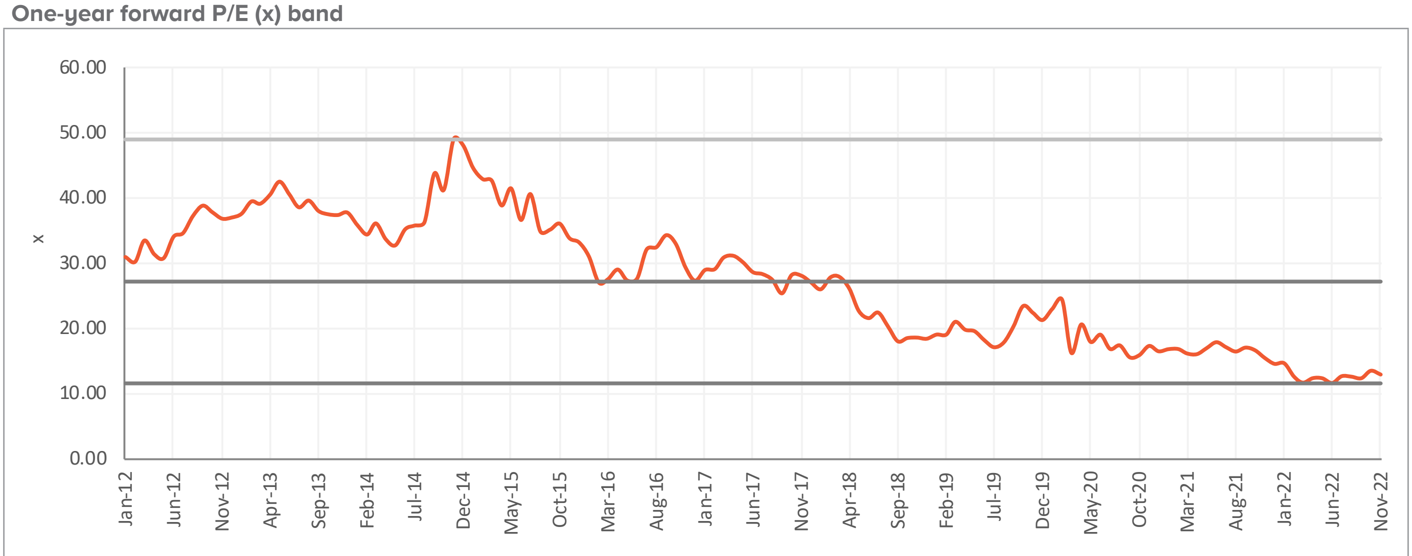
■ **Company Outlook – Volume recovery and price hike improves earnings outlook**

Strong demand from personal mobility and a potential revival in the CV and industrial segments would help boost Castrol's lubricant sales volumes over CY2023E-CY2024E, 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 11%, 8% and 12% CAGR over CY2021-CY2024E, while RoE would remain strong at 50%.

■ **Valuation – Maintain Buy with a revised PT of Rs. 140**

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. Moreover, parent BP's focus on EV batteries could provide Castrol India edge (in supply of EV fluids) in India's transition towards EVs. Valuation of 12.6x CY23E EPS is attractive and is at a significant discount of 50% to its historical average one-year forward P/E multiple of 25x and the stock offers decent dividend yield of ~5% while the balance sheet is robust with a cash position of Rs. 1,504 crore (13% of current market capitalisation) as on September 30, 2022. Hence, maintain a Buy rating on Castrol with a revised PT of Rs. 140.

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 economic slowdown.
- 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 (Old data)

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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