Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Castrol India Ltd

Mixed Q4; Margin beats but 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	Neutral	↔	Neutral
RQ	Positive	↔	Positive
RV	Positive	↔	Positive

ESG Disclosure Score NEW

ESG RISK RATING 23.51
Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

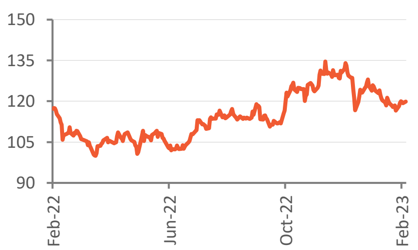
Company details

Market cap:	Rs. 11,847 cr
52-week high/low:	Rs. 137 / 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	11.4
DII	16.6
Others	21.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.1	-4.0	5.2	2.2
Relative to Sensex	-3.4	-2.1	3.5	-4.9

Sharekhan Research, Bloomberg

Summary

- Q4CY2022 PAT of Rs. 193 crore (up 2.6% y-o-y) was largely in-line as beat in per litre margin, higher other income, and lower tax rate gets offset by subdued lubricant sales volume.
- Volume performance was weak with an 8% miss at 48 mn litres (down 4% y-o-y) due to decline in industrial lubricant volume and soft demand from the CV segment. Better-than-expected realisation of Rs. 245/litre (up 12% y-o-y/2.7% q-o-q) reflects proactive pricing and led to 9%/3% beat in gross/EBITDA margin at Rs. 111/Rs. 52 per litre.
- Management has guided to grow its volume by few percentage points above the lube industry's growth outlook of ~4% for CY2023 and is focused to maintain gross margin at CY2022 level. Recent investment in Ki Mobility Solutions would help expand presence in India's automotive aftermarket eco-system via 'myTVS'.
- We maintain Buy on Castrol India with an unchanged PT of Rs. 140, given inexpensive valuation of 12.8x its CY2023E EPS, healthy dividend yield of ~5%, and strong cash position.

For Q4CY2022, Castrol India Limited (Castrol) reported operating profit of Rs. 251 crore (down 5.8% y-o-y; down 2.5% q-o-q), 5% below our estimate of Rs. 264 crore due to an 8% miss in lubricant sales at 48 million litres (down 4% y-o-y), which was offset by better-than-expected per unit EBITDA margin of Rs. 52/litre (down 1.8% y-o-y and was 3% above our estimate). Subdued volume was primarily on account of volume decline in the industrial lubricant segment and some softness in demand from the CV segment, while personal mobility continued to do well. Gross/EBITDA margin of Rs. 111/Rs. 52 per litre, up 2.1%/down 1.8% y-o-y was above our estimate, given the sharp improvement in blended realisation at Rs. 245/litre (up 12.3% y-o-y; up 2.7% q-o-q), led by proactive pricing to protect margin. PAT at Rs. 193 crore (up 2.6% y-o-y; up 3.3% q-o-q) was broadly in-line with our estimate of Rs. 191 crore as miss in operating profit was more than offset by higher other income (up 59% y-o-y) and lower tax rate of 22% (versus assumption of 25%).

Key positives

- Higher-than-expected realisation of Rs. 245/litre, up 12.3% y-o-y/2.7% q-o-q.
- Beat of 9%/3% in gross/EBITDA margin of Rs. 111/Rs. 52 per litre.

Key negatives

- Lower-than-expected lubricant sales volume at 48 million litres, down 4% y-o-y.

Management Commentary

- Management has guided to grow by a couple of percentage points more than India domestic lubes industry growth outlook of 4% and aims to maintain gross margin at CY2022 level.
- Taking proactive pricing action and rigorous cost-management initiatives to protect margins. Inflationary pressures to continue in CY2023, but it has seen softening in prices of base oil price.
- Castrol completed Rs. 488 crore investment in Ki Mobility Solutions (KMS) in January 2023. The strategic collaboration with KMS would help expand the presence in India's automotive aftermarket eco-system via 'myTVS' for both internal combustion engines (ICE) and electric vehicles (EV).
- Castrol maintained a market share at ~20% in the India lubricant market.
- The company further expanded its service and maintenance network to 230 Castrol Auto Service (CAS) centres in 110+ cities across India, 5,215 Castrol Bike Points, and 42 Castrol Express Oil Change outlets across India.

Revision in estimates – We have fine-tuned our CY2023-CY2024 earnings estimate to factor CY2022 P&L and balance sheet numbers.

Our Call

Valuation – Maintain Buy on Castrol with an unchanged 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 the company's focus to diversify revenue stream (auto services) 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 12.8x/11.5x its CY2023E/CY2024E EPS is attractive and is at a significant discount to its historical average one-year forward P/E multiple of 25x. the stock offers decent dividend yield of ~5% and the balance sheet is robust with a cash position of Rs. 1,218 crore (11% of current market capitalisation) as on December 31, 2022. Hence, we maintain our Buy rating on Castrol with an unchanged price target (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	CY22	CY23E	CY24E
Revenue	4,192	4,774	5,284	5,596
OPM (%)	25.4	23.3	23.4	22.9
Adjusted PAT	758	815	928	1,033
% YoY growth	26.4	7.5	13.8	11.4
Adjusted EPS (Rs.)	7.7	8.2	9.4	10.4
P/E (x)	15.6	14.5	12.8	11.5
P/B (x)	7.2	6.3	5.7	5.2
EV/EBITDA (x)	9.9	9.6	8.1	8.0
RoNW (%)	49.6	46.2	46.9	47.7
RoCE (%)	67.0	61.2	58.0	61.4

Source: Company; Sharekhan estimates

Q4 is a mixed bag; Volume disappoints while margin beats estimate

Q4CY2022 operating profit of Rs. 251 crore (down 5.8% y-o-y; down 2.5% q-o-q) was 5% below our estimate of Rs. 264 crore due to an 8% miss in lubricant sales at 48 million litres (down 4% y-o-y), which offset better-than-expected per unit EBITDA margin of Rs. 52/litre (down 1.8% y-o-y and was 3% above our estimate). Subdued volumes were primarily on the account of volume decline in the industrial lubricant segment and some softness in demand from the CV segment, while personal mobility continued to do well. Gross/EBITDA margin of Rs. 111/Rs. 52 per litre, up 2.1%/down 1.8% y-o-y was above our estimate, given the sharp improvement in blended realisation at Rs. 245/litre (up 12.3% y-o-y; up 2.7% q-o-q), led by proactive pricing to protect margins. PAT at Rs. 193 crore (up 2.6% y-o-y; up 3.3% q-o-q) was broadly in-line with our estimate of Rs. 191 crore as miss in operating profit was more than offset by higher other income (up 59% y-o-y) and lower tax rate of 22% (versus assumption of 25%).

Q4CY2022 earnings conference call highlights

- **Target to maintain gross margin:** High forex and inflationary pressures arising from volatile crude oil prices continued in Q4CY2022. The company has taken price hikes and rigorous cost-management initiatives to protect margins. Management expects forex and inflationary pressures to continue in CY2023 but has seen softening in prices of base oil and additives since January 2023. The company will take calibrated pricing decisions based on the inflationary scenario going forward. The company said it will try to maintain CY2022 gross margins going forward. On the EBITDA margin front, management said it is difficult to give a guidance now, as the company's intent is to expand into new segments such as automotive aftercare and electric mobility.
- **Volume growth guidance:** Management expects the lubricant market in India to grow by 4% in CY2023. Castrol has guided to grow by a few percentage point above the industry's growth.
- **KMS investment completed:** In November 2022, Castrol announced a strategic collaboration with KMS to leverage each other's strengths and expand India's automotive aftermarket eco-system via 'myTVS', KMS's digitally integrated multi-brand service platform for two and four-wheelers. The deal included a Rs. 487.5 crore investment by Castrol and acquisition of a 7.09% stake in KMS, which was completed in January 2023. The alliance will also offer the potential for Castrol and KMS to collaborate and partner in select markets beyond India.
- **EV fluids launch:** In the EV space, in 2023, the company will launch Castrol ON range of EV fluids for the aftermarket and collaborate with two-wheeler and four-wheeler OEMs to support their EV transition. In addition, Castrol will support mechanics to get EV-ready with certified trainings, which will help create an eco-system to serve EVs better.
- **Market share:** The company has been able to maintain a market share at ~20% and will continue with its marketing spends of 3-4% of sales, with more focus towards digital marketing going forward.
- **Auto service and maintenance network:** The company further expanded its auto service and maintenance network with 230 Castrol Auto Service (CAS) centers in 110+ cities across India, 5,215 Castrol Bike Points, and 42 Castrol Express Oil Change outlets across India.

Results Rs cr

Particulars	Q4CY22	Q4CY21	Y-o-Y %	Q3CY22	Q-o-Q %
Revenue	**1176.0**	**1090.6**	**7.8**	**1121.1**	**4.9**
Total Expenditure	925.4	824.7	12.2	863.9	7.1
Operating profit	**250.6**	**265.9**	**-5.8**	**257.1**	**-2.5**
Other Income	19.6	12.4	58.5	18.7	5.0
Interest	1.6	0.6	185.5	1.2	27.6
Depreciation	20.8	20.9	-0.5	20.8	0.2
PBT	**247.9**	**256.9**	**-3.5**	**253.8**	**-2.3**
Tax	54.6	68.3	-20.1	66.7	-18.1
Reported PAT	**193.3**	**188.6**	**2.5**	**187.2**	**3.3**
Equity Cap (cr)	98.9	98.9		98.9	
Reported EPS (Rs.)	2.0	1.9	2.5	1.9	3.3
Margins (%)			**BPS**		**BPS**
OPM	21.3	24.4	-307	22.9	-162
Effective tax rate	22.0	26.6	-457	26.3	-425
NPM	16.4	17.3	-85	16.7	-26

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q4CY22	Q4CY21	Y-o-Y %	Q3CY22	Q-o-Q %
Volume (mn litres)	48.0	50.0	-4.0	47.0	2.1
Realisation (Rs./litre)	245	218.1	12.3	238.5	2.7
Gross margin (Rs./litre)	110.9	108.6	2.1	108.4	2.3
EBITDA margin (Rs./litre)	52.2	53.2	-1.8	54.7	-4.6

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Lubricant demand to grow in low to mid-single digits; volatile base oil prices a concern

Lubricant demand is expected to grow at low to mid-single digits in the next couple of years, led by higher demand from the personal mobility space and rival in demand from CVs on account of overall recovery in the Indian economy. We believe large players such as Castrol would continue to gain market share, given premium products. However, volatile base oil prices are a cause of concern and thus we believe lubricant players would continue with their proactive pricing mechanism to protect margins.

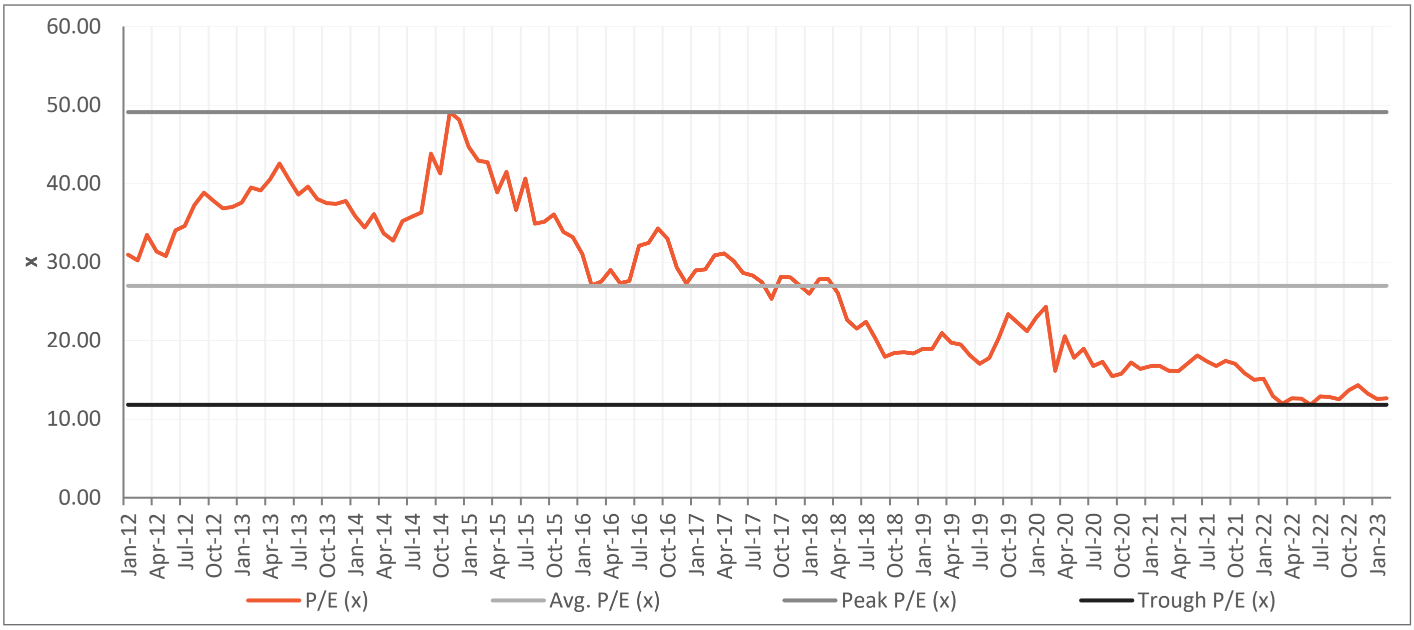
■ Company Outlook – Volume recovery and price hike improves earnings outlook

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 and PAT to register an 8% and 13% CAGR over CY2022-CY2024E, respectively, while RoE would remain strong at 48%.

■ Valuation – Maintain Buy on Castrol with an unchanged 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 the company's focus to diversify revenue stream (auto services) 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 12.8x/11.5x its CY2023E/CY2024E EPS is attractive and is at a significant discount to its historical average one-year forward P/E multiple of 25x. the stock offers decent dividend yield of ~5% and the balance sheet is robust with a cash position of Rs. 1,218 crore (11% of current market capitalisation) as on December 31, 2022. Hence, we maintain our Buy rating on Castrol with an unchanged price target (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 the 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 KMS provides 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 48% 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 a 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 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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Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

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

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