Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 Mar 08, 2023

Medium Risk

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

Source: Morningstar

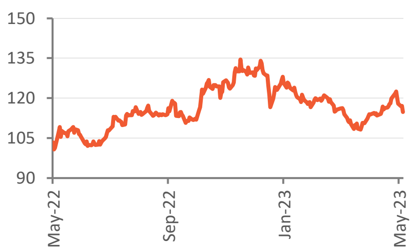
Company details

Market cap:	Rs. 11,338 cr
52-week high/low:	Rs. 137 / 100
NSE volume: (No of shares)	6.6 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	0.7	-3.7	-7.1	11.0
Relative to Sensex	-2.3	-5.8	-7.4	-3.5

Sharekhan Research, Bloomberg

Castrol India Ltd

Subdued Q1; efforts to diversify revenue stream a right step

Lubricants	Sharekhan code: CASTROLIND

Reco/View: Buy	↔	CMP: Rs. 115	Price Target: Rs. 140	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q1CY23 PAT of Rs. 203 crore (down 11.3% y-o-y; up 4.7% q-o-q) was 12% below our estimate due to miss in margin, lower other income and higher tax rate while volume were inline.
- Lubricant sales volume of 55 million litres (down 6.8% y-o-y; up 14.6% q-o-q) was broadly in-line our estimate but EBITDA margin of Rs. 53.6/litre was below our expectations due to a sharp rise in opex while gross margins remained stable q-o-q.
- The management maintained its guidance of growing at a few percentage points above lube industry growth outlook of ~3-5% and maintain EBITDA margins in the range of 23-25%. The focus is to grow in India's automotive aftermarket and thus building eco system, which would get support from recent investment in Ki Mobility Solutions.
- We maintain Buy on Castrol India with an unchanged PT of Rs. 140 given inexpensive valuation of 12.5x/11.2 CY23E/CY24E EPS, healthy dividend yield of ~5-6% and strong cash position.

Castrol India Limited's (Castrol's) Q1CY23 operating profit of Rs. 295 crore (down 7% y-o-y; up 18% q-o-q) was 5% below our estimate of Rs. 309 crore due to lower-than-expected per unit EBITDA margin of Rs. 53.6/litre (flat y-o-y; up 2.7% q-o-q) while lubricant sales volume of 55 million litres (down 6.8% y-o-y; up 14.6% q-o-q) was broadly in-line with our estimate. Miss in margins was primarily due to higher-than-expected operating expenses (employee cost/other expenses up sharply by 7%/13% q-o-q), while per unit gross margin of Rs. 111/lite (flat q-o-q) was in-line despite lower blended realisation of Rs. 235/litre (down 4% q-o-q). PAT at Rs. 203 crore (down 11.3% y-o-y; up 4.7% q-o-q) was 12% below our estimate due to miss in margin, lower-than-expected other income and a higher tax rate of 29.8% (versus assumption of 25.2%).

Key positives

- Sequential recovery in lubricant sales volume at 55 million litres, up 14.6% q-o-q.
- Stable per unit gross margin of Rs. 110/litre (flat q-o-q) despite sequential decline in blended realisation.

Key negatives

- A 4% miss in EBITDA margin at Rs. 53.6/litre due to higher opex.

Management Commentary

- The management aims to grow a couple of percentage more than the India domestic lubes industry growth outlook of 3-5%. Lubricant demand from passenger cars would continue to grow strongly given low car penetration in India.
- Auto service & maintenance workshops would gain momentum from investment in Ki Mobility. Plan for national launch of auto care in this quarter from the pilot stage earlier.
- Base oil price has moderated to $900-950/tonne versus $1000-1100/tonne in Q1CY23 as availability has improved both globally and domestically.
- **Market share –** Castrol gained market share in the passenger car category while the two–wheeler category remained soft. It maintained market share in CV/agriculture category.
- The company further expanded its service & maintenance network in Q1CY23 with 300 Castrol Auto Service (CAS) centers in 100+ cities across India and 5000+ *Castrol Bike Points*.

Revision in estimates – We have fine-tuned our CY23-24 earnings estimate as we adjust our volume expectation given inflationary pressures.

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 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 an edge (in supply of EV fluids) in India's transition towards EVs. Valuation of 12.5x/11.2x CY23E/CY24E 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 a decent dividend yield of ~5-6% while 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 a Buy rating on Castrol with an unchanged 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	5,187	5,493
OPM (%)	25.4	23.3	23.3	22.8
Adjusted PAT	758	815	907	1,011
% YoY growth	26.4	7.5	11.2	11.5
Adjusted EPS (Rs)	7.7	8.2	9.2	10.2
P/E (x)	15.0	13.9	12.5	11.2
P/B (x)	6.9	6.0	5.5	5.0
EV/EBITDA (x)	9.4	9.1	7.9	7.8
RoNW (%)	49.6	46.2	45.9	46.8
RoCE (%)	67.0	61.2	56.7	60.2

Source: Company; Sharekhan estimates

Stock Update

Result Update

Weak Q1; earnings miss estimate on lower margin & high tax rate

Q1CY23 operating profit of Rs. 295 crore (down 7% y-o-y; up 18% q-o-q) was 5% below our estimate of Rs. 309 crore due to lower-than-expected per unit EBITDA margin of Rs. 53.6/litre (flat y-o-y; up 2.7% q-o-q) while lubricant sales volume of 55 million litres (down 6.8% y-o-y; up 14.6% q-o-q) was broadly in-line with our estimate. Miss in margins was primarily due to higher-than-expected operating expenses (employee cost/ other expenses up sharply by 7%/13% q-o-q), while per unit gross margin of Rs. 111/lite (flat q-o-q) was in-line despite lower blended realisation of Rs. 235/litre (down 4% q-o-q). PAT at Rs. 203 crore (down 11.3% y-o-y; up 4.7% q-o-q) was 12% below our estimate due to miss in margin, lower-than-expected other income and a higher tax rate of 29.8% (versus assumption of 25.2%).

Q1CY2023 earnings conference call highlights

- **Outlook/Guidance:** Company maintained its guidance that the lubricant business will grow a few percentages point above the industry's growth rate of 3-5% over the next 3-5 years and EBITDA margin will be at 23-26%. The company will focus on investing in its brand identity, increasing its service centres and workshops and on cost efficiency. Management did not give growth projections of it new initiatives.
- **Market Share:** In the last year the company grew in mid to high double-digits/ single digit in its passenger vehicle/two-wheeler segments respectively whereas there was pressure in the growth of its commercial vehicles segment. Over the last few months, the company has been able to increase/maintain its market share in passenger vehicle/commercial vehicle segments while there has been some decline in the market share in the two-wheeler segment.
- **Brand Relook:** On 28 February, Castrol unveiled its refreshed brand identity globally, including an updated look and feel. The brand refresh is aimed at better reflecting its unique positioning in the market and the opportunities it sees in meeting the changing needs of customers. Company collaborated with JioCinema, for streaming the 2023 TATA Indian Premier League, as an associate sponsor and the partnership is aimed to engage with cricket fans across India and leverage the platform to showcase Castrol's refreshed brand identity.
- **Auto service and maintenance network:** The company further expanded its auto service and maintenance network to over 300 Castrol Auto Service (CAS) centres and over 5000 Castrol Bike Points across India.
- **Others:** 1) Base oil prices were $1000-1100/tonne in Q4CY22 and are now hovering in the range of $900-950. 2) Around 10-11% of revenues come from synthetic products requiring higher quality base oil. 3) Additive costs have risen from Rs. 100 in early 2021 to Rs. 150-160 now.

Results | Rs cr

Particulars	Q1CY23	Q1CY22	YoY (%)	Q4CY22	QoQ (%)
Revenue	**1293.9**	**1235.7**	**4.7**	**1176.0**	**10.0**
Total Expenditure	998.9	918.5	8.7	925.4	7.9
Operating profit	**295.0**	**317.2**	**-7.0**	**250.6**	**17.7**
Other Income	17.6	15.0	17.2	19.6	-10.3
Interest	1.7	0.7	129.2	1.6	5.1
Depreciation	22.7	20.2	12.4	20.8	9.2
PBT	**288.3**	**311.3**	**-7.4**	**247.9**	**16.3**
PBT	288.3	311.3	-7.4	247.9	16.3
Tax	85.8	82.9	3.5	54.6	57.2
Reported PAT	**202.5**	**228.4**	**-11.3**	**193.3**	**4.7**
Equity Cap (cr)	98.9	98.9		98.9	
Reported EPS (Rs.)	2.0	2.3	-11.3	2.0	4.7
EPS	2.0	2.3	-11.3	2.0	4.7
Margins (%)			**BPS**		**BPS**
OPM	22.8	25.7	-287	21.3	149
Effective tax rate	29.8	26.6	312	22.0	774
NPM	15.7	18.5	-283	16.4	-79

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q1CY23	Q1CY22	YoY (%)	Q4CY22	QoQ (%)
Volume (million litres)	55.0	59.0	-6.8	48.0	14.6
Realisation (Rs. /litre)	235	209.4	12.3	245.0	-4.0
Gross margin (Rs. /litre)	110.7	105.1	5.3	110.9	-0.1
EBITDA margin (Rs. /litre)	53.6	53.8	-0.2	52.2	2.7

Source: Company; Sharekhan Research

Outlook and Valuation

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

Lubricant demand is expected to grow at low to low-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, volatile base oil prices are a cause of concern for margins and thus we believe that lubricant makers would continue with proactive pricing actions.

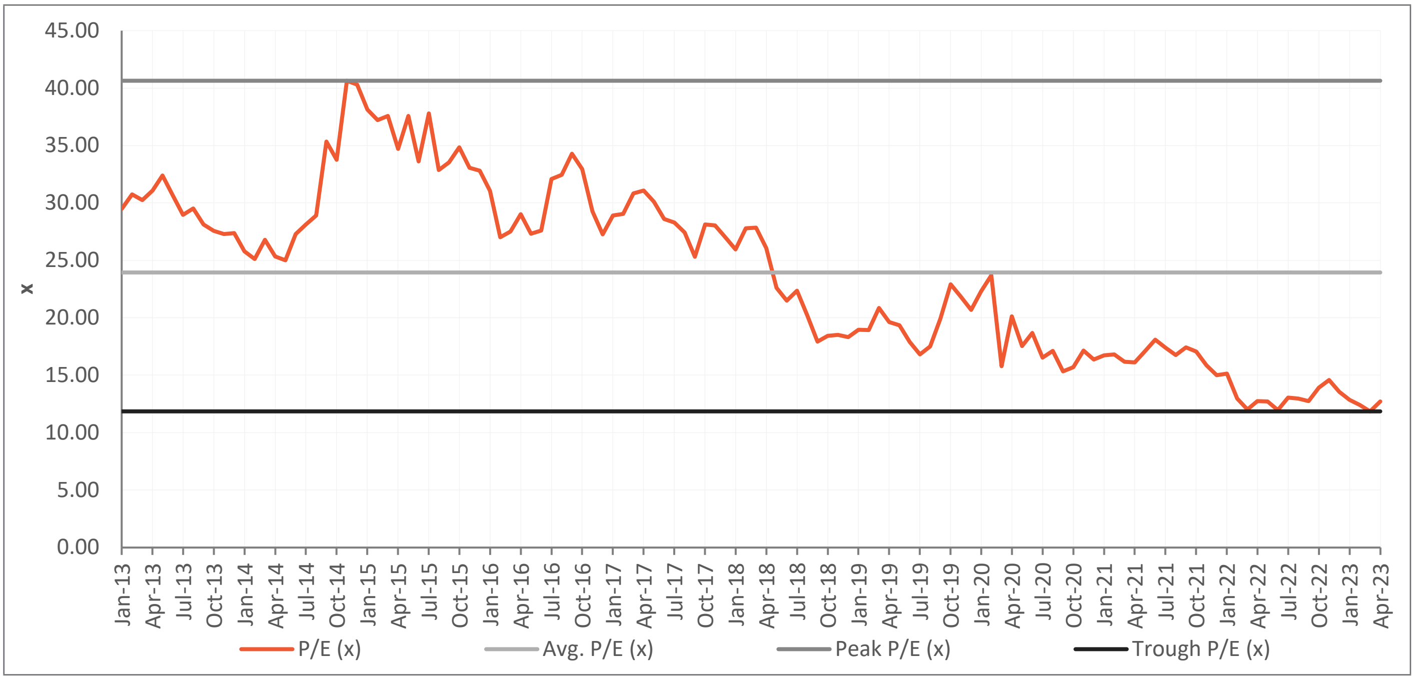
■ Company Outlook – Volume recovery and resilient margin to drive decent growth

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 a 7% and 11% CAGR over CY2022-CY2024E, while RoE would remain strong at 47%.

■ 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 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 an edge (in supply of EV fluids) in India's transition towards EVs. Valuation of 12.5x/11.2x CY23E/CY24E 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 a decent dividend yield of ~5% while 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 a Buy rating on Castrol with an unchanged 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 47% 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 Corp of India	11.29
2	Vanguard Group Inc/The	1.93
3	Republic of Singapore	1.1
4	Aditya Birla Sun Life Asset Manage	1.07
5	First State Investments ICVC	0.65
6	Nippon Life India Asset Management	0.62
7	Mitsubishi UFJ Financial Group Inc	0.61
8	Norges Bank	0.47
9	WisdomTree Inc	0.46
10	Franklin Resources Inc	0.39

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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