Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Castrol India Ltd

Broadly in-line Q2, valuation attractive & healthy dividend yield

Lubricants		Sharekhan code: CASTROLIND	
Reco/View: Buy	↔	CMP: Rs. 144	Price Target: Rs. 165 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q2CY23 PAT of Rs. 225 crore (up 7.4% y-o-y; up 3.1% q-o-q) was 3% below our estimate due to miss in margin and a higher tax rate, while volume beat the estimate.
- Lubricant sales volumes of 58 million litres (up 3.5% y-o-y; up 5.5% q-o-q) was 1% above our estimate but EBITDA margin of Rs. 53.4/litre lagged our expectations mainly due to a higher operating as gross margin was inline.
- CY23 volume growth expectation of 5-7% and guided to sustain EBITDA margins in the range of 23-27%. Base oil prices see a deflationary trend and expect stable prices in H2CY23. The focus is to grow in India's automotive aftermarket and thus building an ecosystem.
- We maintain a Buy on Castrol with a revised PT of Rs. 165 (rollover of PE multiple to CY24E EPS) given inexpensive valuation of 14x CY24E EPS, healthy dividend yield of ~4-5% and strong cash position.

Castrol India Limited's (Castrol's) Q2CY23 operating profit of Rs. 310 crore (up 8% y-o-y; up 5% q-o-q) was 2% below our estimate of Rs. 317 crore due to marginally higher-than-expected operating cost which led to miss in EBITDA margin. Lubricants sales volume grew by 3.6%/5.5% y-o-y/q-o-q to 58 million litres (1% above estimate) but EBITDA margin of Rs. 53.4/litre (up 4.5% y-o-y; down 0.4% q-o-q) was 3% below our estimate. Although gross margin was soft and declined by 0.8%/2% y-o-y/q-o-q to Rs108.5/litre but was in-line with our estimate as beat in blended realisation offset higher-than-expected input costs. PAT at Rs. 225 crore (up 9.2% y-o-y; up 11.2% q-o-q) was 3% below our estimate due to miss in margin and a higher tax rate of 26.1% (versus assumption of 25.2%).

Key positives

- A sequential recovery in lubricant sales volume at 58 million litres, up 5.5% q-o-q.

Key negatives

- A 3% miss in EBITDA margin at Rs. 53.4/litre due to higher opex.

Management Commentary

- The company expects volume growth of 5-7% y-o-y CY23 supported by easing inflation and guided for EBITDA margin of 23-27% for the next 3-5 years. Base oil prices are seeing deflationary trend and expect stable price in H2CY23.
- The company expanded its portfolio in auto care range by offering anti-rust products, wax shine products, chain lubricants, etc.
- The company is planning to increase its distribution network mainly in rural area to increase product penetration. Thermal management of data centers is another growth area that the company is focusing on.
- EV fluids realisations were higher as compared to lubricants. Unlike lubricants, EV fluids does not require replacement throughout its life.
- The company's strategic investment in KI Mobility Solutions aims to expand its presence in service and maintenance for both internal combustion engine (ICE) and electric vehicles (EVs) and leverage Ki mobility's digital and operational capabilities.

Revision in estimates – We maintain our CY23-24 earnings estimate.

Our Call

Valuation – Maintain Buy on Castrol with a revised PT of Rs. 165: 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 15.7x/14.1x CY23E/CY24E EPS is attractive and is at a significant discount of 37% to its historical average one-year forward P/E multiple of 25x. The stock offers a decent dividend yield of ~4-5% while the balance sheet is robust with a cash position of Rs. 991 crore (7% of current market capitalisation) as on June 30, 2023. Hence, we maintain a Buy rating on Castrol with a revised PT of Rs. 165 (rollover of PE multiple to CY24E EPS).

Key Risks

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

Valuation Rs cr

Particulars	CY21	CY22	CY23E	CY24E
Revenue	4,192	4,774	5,187	5,493
Operating profit	1,066	1,111	1,207	1,251
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)	18.8	17.5	15.7	14.1
P/B (x)	8.7	7.6	6.9	6.3
EV/EBITDA (x)	12.2	11.7	10.3	10.1
RoNW (%)	49.6	46.2	45.9	46.8
RoCE (%)	67.0	61.2	56.7	60.2

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 22.14

Updated Jun 08, 2023

Medium Risk

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

Source: Morningstar

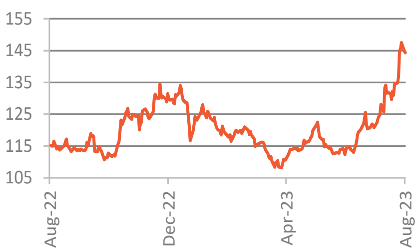
Company details

Market cap:	Rs. 14,273 cr
52-week high/low:	Rs. 152.25/107.70
NSE volume: (No of shares)	9.5 lakh
BSE code:	500870
NSE code:	CASTROLIND
Free float: (No of shares)	48.5 cr

Shareholding (%)

Promoters	51.0
FII	11.4
DII	16.5
Others	21.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.5	18.5	21.8	25.3
Relative to Sensex	16.8	10.2	10.9	10.9

Sharekhan Research, Bloomberg

Marginal Q2 earnings miss; volume see recovery while margin was below estimate

Q2CY23 operating profit of Rs. 310 crore (up 8% y-o-y; up 5% q-o-q) was 2% below our estimate of Rs. 317 crore due to marginally higher-than-expected operating cost which led to miss in EBITDA margin. Lubricants sales volume grew by 3.6%/5.5% y-o-y/q-o-q to 58 million litres (1% above estimate) but EBITDA margin of Rs. 53.4/litre (up 4.5% y-o-y; down 0.4% q-o-q) was 3% below our estimate. Although gross margin was soft, falling 0.8%/2% y-o-y/q-o-q to Rs108.5/litre but was in-line with our estimate as beat in blended realisation offset higher-than-expected input costs. PAT at Rs. 225 crore (up 9.2% y-o-y; up 11.2% q-o-q) was 3% below our estimate due to miss in margin and a higher tax rate of 26.1% (versus assumption of 25.2%).

Key result highlights

- **Volume outlook/Guidance –** The company expects to growth of 5-7% on y-o-y basis. Last year the company had to take price hikes to protect its margins, which led to a decline in volumes. This year, as cost pressure eased, the company expects robust volume growth.
- **Margin outlook –** The management has given margin guidance of 23-27% for next 3-5 years. Since companies sell premium lubricant, margin compression is unlikely.
- **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.
- The company expanded its portfolio by entering the auto care range. Within this segment company plans to sell antirust products, wax shine products, chain lubricants etc.
- In terms of vehicles, personal vehicles account for ~45% of sales, commercial account around 35-40% of sales, balance is industrial lubricants. Industrial lubricants have also as seen good volume growth (9-11%) in the quarter due to growth in the manufacturing sector. The management expects growth to continue in H2CY23.
- **Expansion plans –** The company is planning to increase its distribution network mainly in rural area to increase product penetration. Castrol has also made an investment in KI Mobility Solutions. With this strategic investment, the company aims to expand its presence in service and maintenance for both internal combustion engines (ICEs) and electric vehicles (EV) and leverage Ki mobility's digital and operational capabilities. Thermal management of data centers is another growth area that the company is focusing on.
- **Other:** 1) The Patalganga plant now runs on 100% green renewable energy. 2) The company successfully launched new products like Castrol CRB ESSENTIAL and MAGNATEC SUV 5W30 to expand its product portfolio.

Results

Rs cr

Particulars	Q2CY23	Q2CY22	YoY (%)	Q1CY23	QoQ (%)
Revenue	**1333.8**	**1241.7**	**7.4**	**1293.9**	**3.1**
Total Expenditure	1,024.0	955.6	7.2	998.9	2.5
Operating profit	**309.8**	**286.1**	**8.3**	**295.0**	**5.0**
Other Income	18.6	13.7	35.7	17.6	5.3
Interest	1.5	0.5	200.0	1.7	-10.9
Depreciation	21.8	19.6	11.5	22.7	-4.0
PBT	**305.0**	**279.7**	**9.0**	**288.3**	**5.8**
Tax	79.7	73.5	8.5	85.8	-7.0
Reported PAT	**225.3**	**206.3**	**9.2**	**202.5**	**11.2**
Equity Cap (cr)	98.9	98.9		98.9	
Reported EPS (Rs)	2.3	2.1	9.2	2.0	11.2
EPS	2.3	2.1	9.2	2.0	11.2
Margins (%)			**BPS**		**BPS**
Adjusted OPM	23.2	23.0	18	22.8	42
Effective tax rate	26.1	26.3	-12	29.8	-361
Adjusted NPM	16.9	16.6	28	15.7	124

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q2CY23	Q2CY22	YoY (%)	Q1CY23	QoQ (%)
Volume (mn litres)	58.0	56.0	3.6	55.0	5.5
Realisation (Rs/litre)	230	221.7	3.7	235	-2.3
Gross margin (Rs/litre)	108.5	109.5	-0.8	110.7	-2.0
EBITDA margin (Rs/litre)	53.4	51.1	4.5	53.6	-0.4

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – 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.

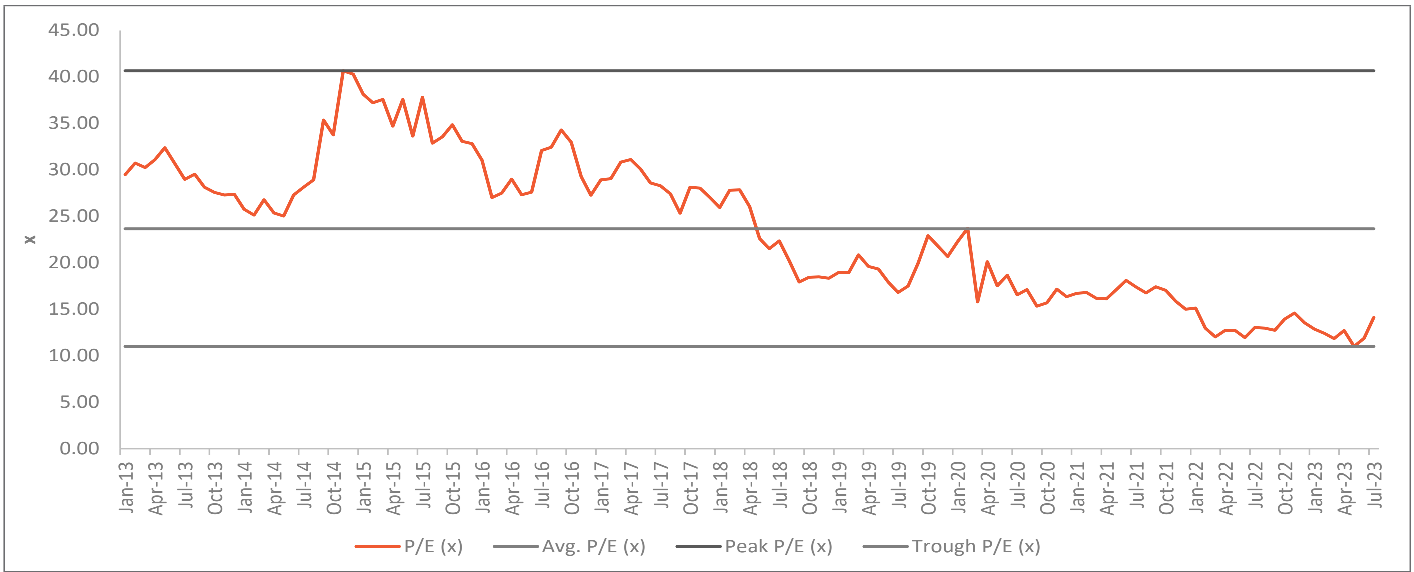
■ Company Outlook – Volume recovery and resilient margin to drive decent growth

Strong demand from personal mobility and a potential revival in the CVs 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 a revised PT of Rs. 165

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 15.7x/14.1x CY23E/CY24E EPS is attractive and is at a significant discount of 37% to its historical average one-year forward P/E multiple of 25x. The stock offers a decent dividend yield of ~4-5% while the balance sheet is robust with a cash position of Rs. 991 crore (7% of current market capitalisation) as on June 30, 2023. Hence, we maintain a Buy rating on Castrol with a revised PT of Rs. 165 (rollover of PE multiple to CY24E EPS).

One-year forward P/E (x) band



Source: Sharekhan Research

About the 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 15% 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	11.3
2	Vanguard Group Inc/The	1.6
3	Republic of Singapore	1.1
4	Aditya Birla Sun Life Asset Manage	1.1
5	Caisse de Depot et Placement du Qu	0.8
6	First State Investments ICVC	0.7
7	Mitsubishi UFJ Financial Group Inc	0.6
8	Nippon Life India Asset Management	0.6
9	WisdomTree Inc	0.5
10	Norges Bank	0.5

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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