Stock Update

Company Update

Powered by the Sharekhan 3R Research Philosophy

Castrol India Ltd

Focus on volume growth & diversification

Lubricants	Sharekhan code: CASTROLIND
Reco/View: Buy ↔	CMP: **Rs. 205** / Price Target: **Rs. 240** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Castrol management is now focused on volume-led growth while maintaining its margin guidance of 22-26%. The company aims to grow above the lubricant industry's growth rate of 4-5% p.a. Expanding presence in rural areas is a key focus.
- Three-point strategy – Onward (mobility focused), Upward (industrial focused), Forward (new opportunities and growth beyond lubricants).
- Enhanced focus to diversify and grow beyond lubricants. Key areas include EV fluids, auto care, maintenance through branded workshops (investment of 7% in KI Mobility) and Castrol oil change through Jio-bp.
- We maintain Buy on Castrol India with an unchanged PT of Rs. 240. A valuation of 19x CY25E EPS seems reasonable given the decent growth outlook, healthy dividend yield of ~3-4%, high RoE of 48% and strong cash position.

We attended the analyst meet of Castrol India Limited (Castrol) which its CFO – Deepesh Baxi addressed. The management is focused on growing lubricant volume above the industry growth rate of 4-5% and developing adjacent businesses like auto care and auto service workshops. Castrol has a three-point strategy - Onward (focus on mobility), Upward (boosting industrials) and Forward (diversification for the future). We maintain our Buy rating on Castrol with an unchanged PT of Rs240.

- **Three-point strategy - Onward, Upward and Forward:** Castrol has refreshed its identity with the three-point strategy of Onward, Upward, forward which aims for growth in its core business and beyond lubricants. Onward is focused on powering growth in mobility (PV/CV), upward aims for boosting industrial performance, and forward represents Castrol's focus on new opportunities and growth beyond lubricants.
- **Volume growth a focus area; margin guidance of 22-26%:** Castrol expects India's lubricant market to grow at a 4-5% rate over the next couple of years and aims to grow above the industry growth rate. The company has launched "CSTRL Express" to help expand its rural presence, and it would remain a key focus area given that 50% of 2W are sold in rural while car penetration is also on rising trend. The management maintained its EBITDA margin guidance of 22-26%.
- **Focus to grow beyond lubricants:** Castrol is focused on diversifying its revenue/earnings estimate beyond lubricants and has emphasised on new areas of – 1) Castrol Express to expand services in rural areas, 2) express oil change services at Jio-bp stations, 3) auto care with premium range of products (available at 20k+ plus workshops), 4) Castrol branded auto service workshops (450+ workshops and invested 7% in KI Mobility). Apart from the above, the company has also launched EV fluid (Castrol ON EV transmission fluid) and focused on leveraging R&D from parent BP on the thermal management of batteries.

Our Call

Valuation – Maintain Buy on Castrol with an unchanged PT of Rs. 240: Castrol's alliance with the Jio-BP retail network provides long-term volume growth opportunity and scope for market share gain while focusing on diversifying 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 20x/19x CY24E/CY24E EPS is still reasonable and is at a significant discount to its historical average one-year forward P/E multiple of 25x, and the stock offers a decent dividend yield of ~3-4% while the balance sheet is robust with a cash position of Rs. 1200 crore (6% of current market capitalisation) as on December 31, 2023. Hence, we maintain a Buy rating on Castrol with an unchanged PT of Rs. 240.

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	CY23	CY24E	CY25E
Revenue	4,192	4,774	5,075	5,379	5,702
OPM (%)	25.4	23.3	23.6	23.4	23.4
Adjusted PAT	758	815	864	1,017	1,074
% YoY growth	26.4	7.5	6.0	17.7	5.6
Adjusted EPS (Rs)	7.7	8.2	8.7	10.3	10.9
P/E (x)	26.8	24.9	23.5	20.0	18.9
P/B (x)	12.4	10.8	9.6	9.2	8.9
EV/EBITDA (x)	17.8	17.2	16.0	14.9	13.9
RoNW (%)	49.6	46.2	43.1	47.1	47.8
RoCE (%)	67.0	61.2	57.8	58.5	58.7

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		↔	

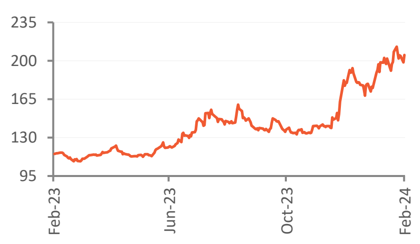
Company details

Market cap:	Rs. 20,297 cr
52-week high/low:	Rs. 214/108
NSE volume: (No of shares)	51.2 lakh
BSE code:	500870
NSE code:	CASTROLIND
Free float: (No of shares)	48.5 cr

Shareholding (%)

Promoters	51.0
FII	10.4
DII	15.9
Others	22.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.5	45.9	42.5	78.6
Relative to Sensex	6.9	35.4	30.0	54.6

Sharekhan Research, Bloomberg

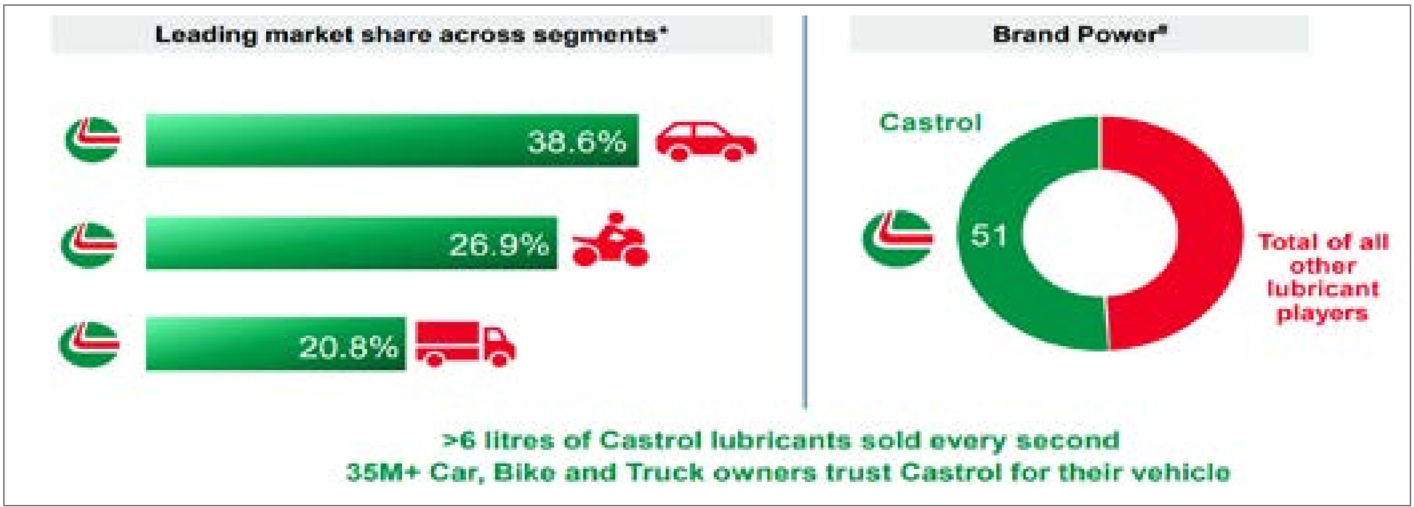
Castrol India analyst meets key takeaways

- **Volume growth:** Castrol's management reports robust volume growth across all categories, with personal mobility accounting for 45-50%, commercial vehicles at 35%, and industrial lubricants at 15%. The company's recent introduction of mass-market products and rural focus may help mitigate the effect of electrification.
- **Improvement in Gross Margin:** During 4QCY23, the company witnessed a sharp margin expansion due to higher volumes and decreased input costs.
- **Margin Guidance:** Castrol's management expects EBITDA margins to remain rangebound between 22-26% as rising personal vehicle penetration and higher sales of premium products could offset margin impact from adverse product mix.
- **Network expansion:** Castrol has expanded its service and maintenance network across India, including Castrol Express outlets for rural markets and partnerships with Ki-Mobility and Jio-BP. During CY23, the company added 3000 outlets in rural areas as this market will remain a key focus area for the company due to growing car ownership and sales of more than 50% sales of 2Ws in rural markets.
- **Capacity utilisation:** Management believes that capacity is not the constraint for higher sales as the company can increase shift from 2 shifts to 3 shifts and tie-ups with third-party manufacturers to increase production.
- **Capex Plan:** Castrol invested Rs 100 crores in supply chain, signage, and distribution in CY2023, with plans to incur capex of Rs 150 crores in CY2024.
- **Industrial Segment:** Castrol aims to expand its market share in the industrial lubes market, primarily in machinery, automotive, metal, defence, and aerospace, with plans to avoid low-margin businesses like process oils and hydraulic oils.
- **New products:** Castrol has launched EV fluids under the Castrol ON brand and collaborated with OEMs like Tata Motors and MG Motors. Despite lower volume than lubricants, margins of EV fluids are comparable to lubricants.

Strong product portfolio with wide applications

Source: Castrol

Substantial market share and brand



Source: Castrol

Castrol – refreshed identity

Source: Castrol

Growing beyond lubricants

Source: Castrol

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 single digits in the next couple of years, led by higher demand from personal mobility space and rival demand from CVs on account of overall recovery in the Indian economy. 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.

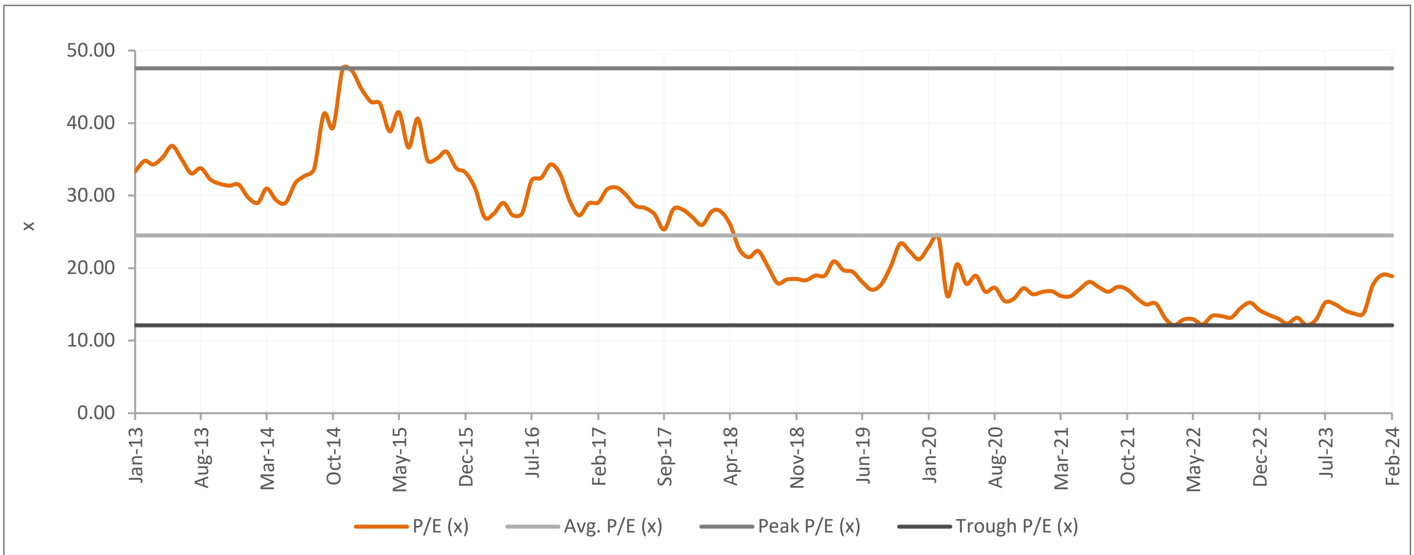
■ Company Outlook – Volume recovery and resilient margin to drive decent growth

Strong demand from personal mobility and a potential revival in the CV and industrial segments would help boost Castrol's lubricant sales volumes over CY2024E-CY2025E. At the same time, margins are expected to remain healthy, led by moderation in base oil price and benefit of operating leverage. Hence, we expect Castrol's PAT to register an 11% CAGR over CY2023-CY2025E, while RoE would remain at 48%.

■ Valuation – Maintain Buy on Castrol with an unchanged PT of Rs. 240

Castrol's alliance with the Jio-BP retail network provides long-term volume growth opportunity and scope for market share gain while focusing on diversifying 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 the supply of EV fluids) in India's transition towards EVs. Valuation of 20x/19x CY24E/CY24E EPS is still reasonable. It is at a significant discount to its historical average one-year forward P/E multiple of 25x. The stock offers a decent dividend yield of ~3-4% while the balance sheet is robust with a cash position of Rs. 1200 crore (6% of current market capitalisation) as on December 31, 2023. Hence, we maintain a Buy rating on Castrol with an unchanged PT of Rs. 240.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Castrol, a 51% most significantBP Plc subsidiary, is India's most significant private sector lubricant player. The company caters to the automotive, industrial, marine, and energy segments. The company derives 40-45% of its volume from personal mobility, the industrial segment contributed 15% 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 Ki Mobility provide long-term volume growth opportunity, the management's renewed focus to gain share could result in better volume growth in the coming years despite the overall muted outlook for lubricant demand (given the 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 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	1.89
3	Nippon Life India Asset Management	0.84
4	Caisse de Depot et Placement du Qu	0.8
5	First Sentier Investors ICVC	0.69
6	Mitsubishi UFJ Financial Group Inc	0.63
7	WisdomTree Inc	0.59
8	Dimensional Fund Advisors LP	0.52
9	Norges Bank	0.47
10	Franklin Resources Inc	0.45

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

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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

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Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

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