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YEARS

# Initiating Coverage Castrol India Ltd.

06-Aug-2020





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Lubricants	Rs. 116.7	Buy at LTP and add on dips to Rs 106-108 band	Rs. 128	Rs.136	2 quarters

HDFC Scrip Code	CASINDEQNR
BSE Code	500870
NSE Code	CASTROLIND
Bloomberg	CSTR.L IN
CMP Aug 05, 2020	116.7
Equity Capital (Rscr)	494.6
Face Value (Rs)	5.0
Equity Share O/S (cr)	98.9
Market Cap (Rs crs)	11544.0
Book Value (Rs)	13.8
Avg. 52 Wk Volumes	1370536
52 Week High	162.1
52 Week Low	89.7

Share holding Pattern % (June, 2020)	
Promoters	51.0
Institutions	30.1
Non Institutions	18.9
Total	100.0

## Fundamental Research Analyst

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### Our Take:

Given the rapid pace of industrialization and good growth in automobile sales, we are comfortable about the slow but sure growth prospects for lubricants market and business growth of Castrol over the medium term to long term. Lubrication industry is likely to grow by ~4-5 per cent over the next 2-3 years although there are challenges due to demand disruption on account of COVID-19 pandemic, intensifying competition, slowdown in global/domestic macro-economic factors and rising popularity of Electric vehicles(EVs). However, Castrol is in a strong position to withstand these challenges on account of its strong brands, technology and enduring relationships with key stakeholders.

Following the implementation of BS-VI norms in the Industry, Castrol has launched BS-VI ready range of products across categories, which can also be used in BS-III/IV vehicles. This range includes Castrol VECTON Long Drain 15W40 CK4 commercial vehicle engine oil, which is carbon-neutral certified and powers trucks with an extended drain interval of up to 1,20,000 kilometers. Apart from this, Its Silvassa plant expansion is on track and is expected to commence operations by 2021 (expansion from 100m liters to 140m liters). Although competition remains intense and the industry volumes are likely to grow in low single digits, Castrol enjoys strong brand equity, distribution and great operational/financial management.

### Valuations & Recommendation:

In light of the possible onslaught by EVs, the company is looking at different revenue streams for the future. The deal with 3M is a reflection of the company's diversification into new avenues. This deal signed in May 2019 will to bring a range of market leading vehicle care products to the automotive after-market. A range of 3M-Castrol branded bike and car care products including shampoo, glass cleaner, cream wax, dashboard and tyre dressers will be available across India. In July2020, Castrol signed a deal with Jio-BP that will enable Castrol lubricants to enhance reach and visibility at 1,400 Jio-BP retail sites across the country, and sites are planned to expand to 5,500 sites in the next five years. Company is confident about prospects of its business in India over the long term and has decided to continue making investments in India unabated by recent slow growth. Lower crude oil and lube oil prices augur well for the margin trajectory. Overall the company faces challenges on volume growth front but the current valuation adequately discounts that. **We feel investors could buy the stock at LTP and add on dips to Rs 106 –108 band (~12.5xCY21E EPS). Base case fair value of the stock is Rs 128 (15.0xCY21E EPS) and the bull case fair value of the stock is Rs 136 (16.0xCY21E EPS) over the next 2 quarters. At the CMP of Rs 116.7 the stock trades at 13.7xCY21E EPS.**



## Financial Summary

Particulars (Rs cr)	Q2CY20	Q2CY19	YoY-%	Q1CY20	QoQ-%	CY18	CY19	CY20E	CY21E
Total Operating Income	490.6	1039.6	-52.8	688.0	-28.7	3904.6	3876.8	2883.2	3737.5
EBITDA	95.3	284.3	-66.5	173.0	-44.9	1017.7	1070.8	1153.0	723.7
Depreciation	20.6	16.6	24.1	22.2	-7.2	55.6	69.7	84.0	78.1
Other Income	15.2	15.9	-4.4	19.8	-23.2	84.3	64.8	87.2	78.5
Interest Cost	1.4	0.3	366.7	1.1	27.3	1.1	1.2	4.8	5.1
Tax	23.1	100.6	-77.0	44.3	-47.9	390.1	319.5	187.8	295.7
APAT	65.4	182.7	-64.2	125.2	-47.8	708.3	827.4	534.4	841.5
Diluted EPS (Rs)	0.7	1.8	-64.2	1.3	-47.8	7.2	8.4	5.4	8.5
RoE-%						58.6	60.5	36.7	49.4
P/E (x)						16.3	14.0	21.6	13.7
EV/EBITDA						10.1	9.2	14.5	9.1

(Source: Company, HDFC sec Research)

## Recent Triggers

### Castrol's focus on product development for BS VI could bring earning's visibility going forward

Castrol India has announced its BS VI readiness with a range of lubricants across categories that offer industry-first features that take the country one step closer to a low-carbon future. Castrol has reinforced its leadership by leveraging the company's access to global R&D and technology, including its experience from the Euro 6 standards implemented in Europe a few years ago. Castrol is now ready with lubricants that complement the Government of India's mission towards cleaner and greener mobility. Several Castrol power brands are part of its BS VI ready portfolio including two-wheeler, passenger car and commercial vehicle engine oils which promise to continue offering enhanced quality and performance to customers.

### Volume recovery is expected in H2CY20 due to relaxation of lockdown

Castrol's volume declined sharply in H1CY20 as the nationwide lockdown has impacted demand for lubricants across the automotive and industrial segments. Now, Government has started to implement initial phases of unlock as per the situation. With the likely end of the lockdown in various locations across the country, lubricant demand would also normalise as the fundamental demand drivers (rising



demand from personal mobility) are well placed. H1CY20 has seen sharp fall in volume growth at more than ~35 per cent, but we expect a recovery in volume growth in H2CY21. Realization growth was impacted due to COVID-19 and scheme announced to aid dealers (has ended in Q2CY20). We expect Castrol’s lubricants volume to decline by ~19-20 per cent in CY20 and but expect sharp recovery in CY21.

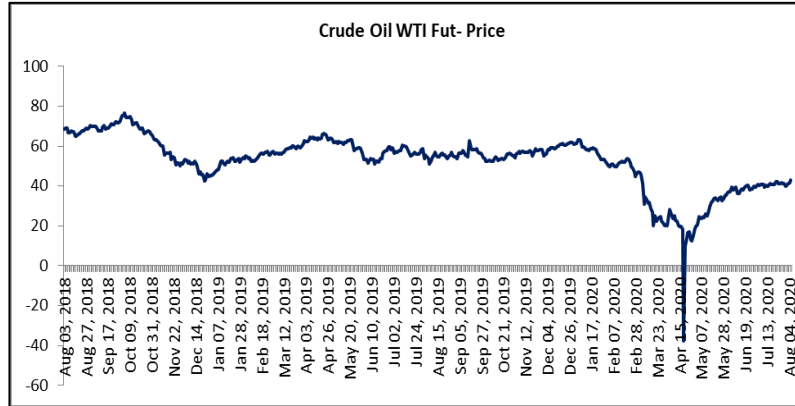
### **Reliance Industries, BP start fuel retailing joint venture under this brand to boost Castrol’s volume growth**

Global energy major BP plc and Reliance Industries Ltd announced formation of their fuel retailing joint venture under the brand ‘Jio-bp’ on July-20. BP had bought 49 per cent stake in the 1,400-odd petrol pumps and 31 aviation turbine fuel (ATF) stations owned by Reliance Industries Ltd for US\$ 1 billion. The joint venture, where RIL holds the remaining 51 per cent, has now commenced operations. The joint venture will begin selling fuels and Castrol lubricants with immediate effect from its existing retail outlets, which will be rebranded to ‘Jio-bp’ in due course. It will leverage Reliance’s presence across 21 states and its millions of consumers through the Jio digital platform. BP (the parent of Castrol) will bring its extensive global experience in high-quality differentiated fuels, lubricants, retail, and advanced low carbon mobility solutions.

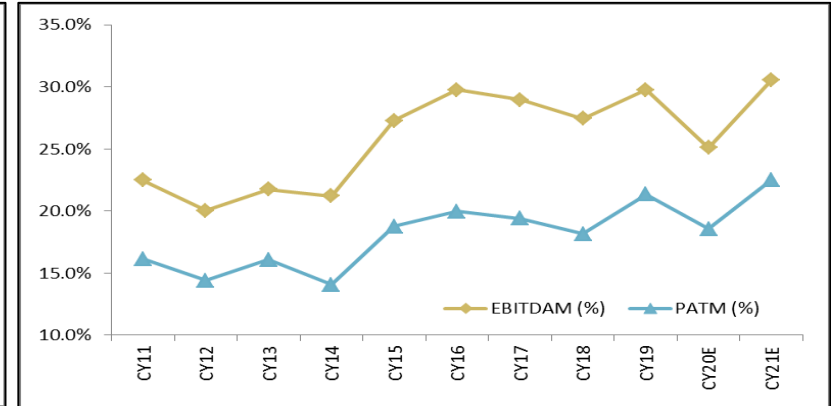
### **Lower crude oil price to expand its margins**

Castrol’s margin outlook has improved as price of key raw materials (base oil and additives – crude derivatives) have declined in line with the fall in the crude oil prices. With the falling trend in crude oil prices, raw material costs (base oil prices) are not expected to remain soft, aiding the improvement in margins. Lower raw material costs (base oil prices have declined by ~31% since January 2020) and better procurement would lower raw material cost and drive gross margin expansion. If the Brent crude price sustains in the range of USD 40-45/bbl and as new base oil capacities are commissioned globally, base oil prices could fall further, increasing Castrol’s gross margins.

## Crude Oil Prices



## Margins-%



(Source: Company, HDFC sec Research)

### Long term Triggers

#### **Established and leading lubricant manufacturer, diversified product portfolio, wide presence, and strong clientele**

- Castrol India is one of the leading manufacturers of automotive and industrial lubricants in the Indian lubricant market and owns around 20% market share in the domestic industry. The company is mostly involved in the business of manufacturing lubricants for protection, cleaning, cooling, rust-proof and sealing.
- Castrol has 100+ years of market presence in India and lubricants is the 3rd largest business of BP lubricants worldwide. The company has 3 blend plants and 5 offices in India. On product branding, the company has famous and well-known brands like Activ, Turbomax, GTX, Magnatec etc. which has wide acceptance in the Indian auto market. Castrol India further has pan India presence with 350+ distributors and 150,000+ retail outlets.
- Castrol India has access to global technology innovations and management experience from its parent company Castrol Worldwide which has a presence in 120+ countries. Castrol is the part of the British Petroleum group. The company is also a trusted supplier to OEMs like Maruti Suzuki, Tata Motors, Mahindra, JCB, Audi, Bosch etc.
- Castrol operates in 4 segments namely Two Wheeler Lubrication, Car Lubrication, Commercial Vehicle lubrication and Heavy Machinery Lubrication. In the two-wheeler, Company operates the Castrol Active brand and has the largest volume share in the

market. In the Car segment, GTX and Magnatec are driving the growth for the company. Castrol Turbomax is the brand positioned towards heavy-duty diesel engines used in Trucks and Buses. In heavy machinery segment, the company has high volume clients like JCB, Tata Steel, SAIL, CAT, JSW Steel, GETRAG etc. Overall the business model of the company is well diversified with a focus on core growth.

### **Strategic partnership with Auto companies could help to add incremental volume growth going forward**

Castrol India has been engaging with OMC and auto manufacturers to sell and develop its products over the periods. The company entered into strategic partnerships with Ford India, Honda two-wheelers, Jawa Motorcycles and Renault India. On 5<sup>th</sup> Aug, 2019, Honda Motorcycle & Scooter India Pvt. Ltd. joined hands with Castrol to announce the commencement of a strategic partnership. As part of the agreement, Honda will endorse a new range of Castrol Activ lubricants launched exclusively for their two-wheelers. The new ranges of engine oils have also been extensively tested by Honda to ensure that they provide optimum performance across all conditions in India. On 18th Dec, 2019, Renault, the number one European brand in India, announced a strategic partnership with Castrol India Limited. The alliance for supply of exclusive after sales engine oil lubricants is effective from 1st January 2020. This announcement is an extension of a global strategic partnership between Group Renault and Castrol.

### **Robust balance sheet and strong financial track record**

- Castrol's revenues from operations rose from Rs 2993cr (CY11) to Rs 3877 cr (CY19) - ~4% CAGR over the period. The Company reported EBITDA margin at a range of 27-30% and PAT margin at a range of 18.5-21% over the last 2 years.
- The working capital has remained positive and the capex has also remained stable over the years. However, the growth is slowing down for the company due to market saturation and electrification of vehicles in India.
- Company has zero debt to equity status and company has no further plan to raise any debt going forward. Company has sufficient cash and cash equivalent for further investment to expand its business going forward. As on 30th June, 2020, Company has cash and cash equivalent of Rs 1107cr and free cash flow to Enterprise value stood at 7.6 per cent in CY 19 vs 4.5 percent in CY18.
- Company has a track record of consistent on dividend payout to its shareholders over the periods. The dividend payout amounts to close to 40% of the post-tax profit and dividend yield (based on CY19 dividends) stands at 4.7percent.
- Company has stable profitability and hence there is no concern on the solvency of the company. The current and quick ratio is also above the minimum threshold which shows good liquidity of assets.



- The inventory days has increased from 41 days to 45 days and the payable period also declined from 50 days to 44 days, as on 31st Dec 2020. It indicates good bargaining power with suppliers and the receivable days have increased slightly over the recent years.

### What could go wrong?

- Castrol India witnessed pressure on volumes as well as in its last quarterly earnings report, on the back of muted demand from the automotive industry and lockdown across the country. Competition in the lubricants market, slowdown in volume growth due to lower demand/high refill intervals due to technology improvement and poor growth in auto industry and strict government's emission norms are key concerns.
- There is also a trend of some OEMs introducing lubricants under their own brand name, further impacting the competitive landscape. The country's largest passenger carmaker Maruti Suzuki India (MSIL) launched Ecstar, Suzuki's global brand of lubricants, coolant and car care products in the country.
- The effect of Covid-19 will be disrupted supply chains, low absorption of fixed costs, labour crunch and production loss. The management may defer some capex to maintain the cash position of the company.
- Significant INR depreciation could impact the growth of Company as the raw material is priced based on import parity in local Rupees.
- Crude is expected to increase in terms of prices and base oil prices will depend not only on crude, but will also depend on the capacity of the market and supply and demand situation. Increase in input costs could impact its margins.
- Growing popularity of Electric Vehicles could dampen the demand for lubricants as EVs have very less moving parts and hence require minimal lubrication. To counter this threat, its parent in Q1CY20, signed agreements with MG Motors and Tata Motors for supply of EV fluids. However, Castrol India expects a timeframe of minimum 10 years before EV popularity gains a sizeable proportion in India.

### Company Profile:

Castrol India Ltd is the second largest player in Indian lubricant industry mainly catering to the automotive and industrial segments. The company has a market share (in value terms) of 20 per cent+ in the domestic lubricants market. Parent Company Castrol Ltd (a British Petroleum (BP) group company) owns 51 percent stake in CIL and CIL gets advantage from exclusive tie-ups with original equipment manufacturers (OEM) due to global tie-ups of automobile companies with BP. Castrol has one of the largest manufacturing and marketing networks amongst the lubricant companies in India. It has manufacturing plants located at Silvassa, Patalganga and Paharpur.

## Peer Comparison

Company	CMP Rs.	Mar Cap Rs.Cr.	EPS 12M Rs.	OPM %	NPM %	Div Yld %	ROE %	Debt / Eq	P/E	P/BV
Castrol India	116.7	11544.0	6.5	28.1	21.4	4.7	65.4	0.0	17.7	9.1
Gulf Oil Lubric.	680.2	3417.2	40.5	17.4	12.3	1.0	33.7	0.5	16.9	4.5
Savita Oil Tech	662.9	922.6	67.2	7.5	4.7	3.0	13.6	0.0	9.7	1.1

## Financials

### Income Statement

(Rs Cr)	CY17	CY18	CY19	CY20E	CY21E
<b>Net Revenues</b>	<b>3568.9</b>	<b>3904.6</b>	<b>3876.8</b>	<b>2883.2</b>	<b>3737.5</b>
Growth (%)	6.3	9.4	-0.7	-25.6	29.6
Operating Expenses	2551.2	2833.8	2723.8	2159.5	2595.7
<b>EBITDA</b>	<b>1017.7</b>	<b>1070.8</b>	<b>1153.0</b>	<b>723.7</b>	<b>1141.8</b>
Growth (%)	3.1	5.2	7.7	-37.2	57.8
<b>EBITDA Margin (%)</b>	<b>28.5</b>	<b>27.4</b>	<b>29.7</b>	<b>25.1</b>	<b>30.6</b>
Depreciation	45.5	55.6	69.7	84.0	78.1
<b>EBIT</b>	<b>972.2</b>	<b>1015.2</b>	<b>1083.3</b>	<b>639.7</b>	<b>1063.8</b>
Other Income	83.7	84.3	64.8	87.2	78.5
Interest expenses	1.2	1.1	1.2	4.8	5.1
<b>PBT</b>	<b>1054.6</b>	<b>1098.4</b>	<b>1146.9</b>	<b>722.1</b>	<b>1137.2</b>
Tax	378.3	390.1	319.5	187.8	295.7
<b>RPAT</b>	<b>676.3</b>	<b>708.3</b>	<b>827.4</b>	<b>534.4</b>	<b>841.5</b>
Growth (%)	<b>3.2</b>	<b>2.4</b>	<b>16.8</b>	<b>-35.4</b>	<b>57.5</b>
EPS	7.0	7.2	8.4	5.4	8.5

### Balance Sheet

As at Dec	CY17	CY18	CY19	CY20E	CY21E
<b>SOURCE OF FUNDS</b>					
Share Capital	494.6	494.6	494.6	494.6	494.6
Reserves	525.6	713.2	872.4	961.6	1209.6
<b>Shareholders' Funds</b>	<b>1020.2</b>	<b>1207.8</b>	<b>1367.0</b>	<b>1456.2</b>	<b>1704.2</b>
Long Term Debt	0.0	0.0	0.0	0.0	0.0
Net Deferred Taxes	-55.2	-57.0	-58.5	-61.4	-64.5
Long Term Provisions & Others	15.9	15.8	21.4	22.5	23.6
<b>Minority Interest</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Total Source of Funds</b>	<b>980.9</b>	<b>1166.6</b>	<b>1329.9</b>	<b>1417.3</b>	<b>1663.3</b>
<b>APPLICATION OF FUNDS</b>					
Net Block (Incl. CWIP)	196.2	223.5	227.0	223.0	220.0
CWIP	0.0	0.0	0.0	0.0	0.0
Other Non-Current Assets	153.8	110.1	107.8	113.2	118.8
<b>Total Non Current Assets</b>	<b>350.1</b>	<b>333.6</b>	<b>334.8</b>	<b>336.2</b>	<b>338.8</b>
Inventories	319.6	414.6	304.7	276.5	337.9
Trade Receivables	285.0	438.9	482.0	371.3	481.3
Cash & Equivalents	784.2	742.2	946.1	1019.3	1199.4
Other Current Assets	183.0	109.6	102.7	111.8	99.4
<b>Total Current Assets</b>	<b>1571.7</b>	<b>1705.3</b>	<b>1835.5</b>	<b>1778.8</b>	<b>2117.9</b>
Short-Term Borrowings	0.0	0.0	0.0	0.0	0.0
Trade Payables	606.6	538.5	471.8	347.6	460.8
Other Current Liab & Provisions	334.2	333.8	368.6	350.2	332.7
<b>Total Current Liabilities</b>	<b>940.9</b>	<b>872.3</b>	<b>840.4</b>	<b>697.7</b>	<b>793.5</b>
Net Current Assets	630.9	833.0	995.1	1081.1	1324.5
<b>Total Application of Funds</b>	<b>980.9</b>	<b>1166.6</b>	<b>1329.9</b>	<b>1417.3</b>	<b>1663.3</b>



## Cash Flow Statement

Rs Cr)	CY17	CY18	CY19	CY20E	CY21E
Reported PBT	1,070.1	1,098.4	1,146.9	722.1	1,137.2
Non-operating & EO items	-53.9	-57.3	-42.2	-17.0	-16.2
Interest Expenses	1.2	1.1	1.2	4.8	5.1
Depreciation	45.5	55.6	69.7	84.0	78.1
Working Capital Change	-65.4	-148.7	12.6	14.7	-58.2
Tax Paid	-389.2	-399.7	-308.7	-187.8	-295.7
<b>OPERATING CASH FLOW ( a )</b>	<b>608.3</b>	<b>549.5</b>	<b>879.5</b>	<b>620.9</b>	<b>850.3</b>
Capex	-35.5	-78.0	-99.3	-80.0	-75.0
Free Cash Flow	572.8	471.5	780.2	540.9	775.3
Investments	142.5	92.0	-398.0	-6.6	-2.0
Non-operating income	44.4	52.1	49.1	-7.9	8.7
<b>INVESTING CASH FLOW ( b )</b>	<b>151.4</b>	<b>66.1</b>	<b>-448.2</b>	<b>-94.5</b>	<b>-68.3</b>
Debt Issuance / (Repaid)	0.0	0.0	0.0	0.0	0.0
Interest Expenses	-1.2	-1.1	-1.2	-4.8	-5.1
FCFE	571.6	470.4	779.0	536.1	770.2
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0
Dividend	-654.6	-566.3	-626.5	-494.6	-494.6
<b>FINANCING CASH FLOW ( c )</b>	<b>-655.8</b>	<b>-567.4</b>	<b>-627.7</b>	<b>-499.4</b>	<b>-499.7</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>103.9</b>	<b>48.2</b>	<b>-196.4</b>	<b>27.0</b>	<b>282.3</b>
<b>CLOSING BALANCE</b>	<b>215.5</b>	<b>263.7</b>	<b>67.2</b>	<b>94.2</b>	<b>376.5</b>

## One Year Stock Price Chart



## Key Ratios

(Rs Cr)	CY17	CY18	CY19	CY20E	CY21E
EBITDA Margin	28.5	27.4	29.7	25.1	30.6
EBIT Margin	27.2	26.0	27.9	22.2	28.5
APAT Margin	19.4	18.1	21.3	18.5	22.5
RoE	67.8	58.6	60.5	36.7	49.4
RoCE	103.5	91.0	84.0	49.9	67.0
<b>Solvency Ratio</b>					
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
D/E	0.0	0.0	0.0	0.0	0.0
<b>PER SHARE DATA</b>					
EPS	7.0	7.2	8.4	5.4	8.5
CEPS	7.5	7.7	9.1	6.3	9.3
BV	10.3	12.2	13.8	14.7	17.2
Dividend	7.0	5.0	5.5	5.0	5.0
<b>Turnover Ratios (days)</b>					
Debtor days	29.1	41.0	45.4	47.0	47.0
Inventory days	32.7	38.8	28.7	35.0	33.0
Creditors days	62.0	50.3	44.4	44.0	45.0
<b>VALUATION</b>					
P/E	16.7	16.3	14.0	21.6	13.7
P/BV	11.3	9.6	8.4	7.9	6.8
EV/EBITDA	10.4	10.1	9.2	14.5	9.1
EV / Revenues	3.0	2.8	2.7	3.7	2.8
Dividend Yield (%)	6.0	4.3	4.7	4.3	4.3
Dividend Payout (%)	120.1	83.8	78.9	83.3	70.5

(Source: Company, HDFC sec Research)



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