RETAILRESEARCH

Stock Update

Castrol India Ltd.

Sept 20, 2021

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20 YEARS

Castrol India Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Lubricants	Rs 136.45	Buy in the Rs 135-138 band & add more on dips to Rs 119.50-122.50 band	Rs 151	Rs 169	2 quarters

HDFC Scrip Code	CASINDEQNR
BSE Code	500870
NSE Code	CASTROLIND
Bloomberg	CSTRL IN
CMP Sep 17, 2021	136.45
Equity Capital (Rs cr)	494.5
Face Value (Rs)	5
Equity Share O/S (cr)	98.9
Market Cap (Rs cr)	13,482
Book Value (Rs)	15.1
Avg. 52 Wk Volumes	1104306
52 Week High	154.9
52 Week Low	104.0

Share holding Pattern % (June, 2021)	
Promoters	51.0
Institutions	28.6
Non Institutions	20.4
Total	100.0

Retail Research Risk Rating:

* Refer at the end for explanation on Risk Ratings

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Our Take:

Castrol India is an automotive and industrial lubricant manufacturing company. The company owns around 20% market share in the overall Indian lubricants market. Castrol's market share improved 2% across all segments in Q2CY21. As per Nielsen, Castrol's market share in the bazaar segment stands at 22-23%, while the second closest player stands at 7%. In 2W, 4Ws and CVs, Castrol had 26-27%, ~35% and ~18% market share respectively.

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% 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. Despite weak demand due to lockdown, Castrol reported realization at Rs197.7/ltr in Q2CY21 vs. Rs 186.7/ltr in Q1CY21. Castrol has taken three price hikes since January; as base oil prices doubled in last one year. Castrol has high pricing power and commands premium for its products.

On 06 Aug, 2020, we had initiated coverage on Castrol India Ltd and recommended and buy at LTP of Rs 116.7 & add on dips to Rs 106-108 band for base case target of Rs 128 and bull case target of Rs 136. The stock achieved its both targets before expiry of call. Given healthy growth outlook and strong profitability numbers in Q2CY21, we have now revised earnings and increased target price for the stock.

Valuation & 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 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 July 2020, 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. Overall the company faces challenges on volume growth front but the current valuation adequately discounts that. Dividend yield of __% is an added attraction. Easing of Covid restrictions will drive a healthy recovery in demand across segments over the next few quarters.

We feel investors could buy the stock in the Rs 135-138 band and add on dips to Rs 119.5 –122.5 band (14.0xCY22E EPS). Base case fair value of the stock is Rs 151 (17.5xCY22E EPS) and the bull case fair value of the stock is Rs 169 (19.5xCY22E EPS) over the next 2 quarters. At the CMP of Rs 136.45 the stock trades at 15.8x CY22E EPS.

Financial Summary

Particulars (Rs cr)	Q1CY21	Q2CY20	YoY-%	Q1CY20	QoQ-%	CY19	CY20	CY21E	CY22E
Total Operating Income	890	491	81.3	1139	-21.9	3877	2997	4170	4424
EBITDA	198	95	107.2	340	-41.9	1071	1153	814	1052
Depreciation	20	21	-3.4	22	-7.4	70	87	88	91
Other Income	13	15	-12.5	14	-7.0	65	62	67	73
Interest Cost	1	1	-50.0	1	16.7	1	4	3	3
Tax	50	23	117.3	89	-43.4	320	202	278	301
APAT	140	65	114.1	244	-42.5	827	583	750	855
Diluted EPS (Rs)	1.4	0.7	114.8	2.5	-42.0	8.4	5.9	7.6	8.6
RoE-%						65.3	41.9	50.3	51.0
P/E (x)						16.3	23.2	18.0	15.8
EV/EBITDA						10.9	15.0	11.6	10.3

(Source: Company, HDFC sec)

Castrol Q2CY21 results key takeaway

- Castrol India Ltd's revenue was almost inline with expected numbers and net profit was above expected numbers in Q2CY21. The quarter witnessed challenges in the form of localized lockdowns, muted demand, as well as a sharp rise in input costs.
- Net Sales grew by 81.3% YoY to Rs 890 crore in Q2CY21 due to lower base. EBITDA was almost double the same quarter previous year to Rs 198 crore vs. Rs 95 crore, supported by higher revenue growth. EBITDA margin was up by 280bps YoY to 22.2% in Q2CY21.
- The input costs also went up sharply in line with the spike in commodity inflation. Price of SN-500, a key base oil, jumped 32-45% qoq with 1-2 month lag amid lower supplies. Castrol continues to invest in its brand and spent Rs.35-40 cr on advertising (double YoY) in Q2CY21.
- Net Profit grew by more than two folds to Rs 140 crore in Q2CY21, due to more efficient absorption of fixed costs. PAT margin ramped up by 240bps YoY to 15.7% in Q2CY21 vs. 12.6% in Q1CY21.
- The company recommended an interim dividend of Rs 2.50 per share (2020: Interim dividend at Rs 2.50 per share; Final dividend at Rs 3.00 per share).

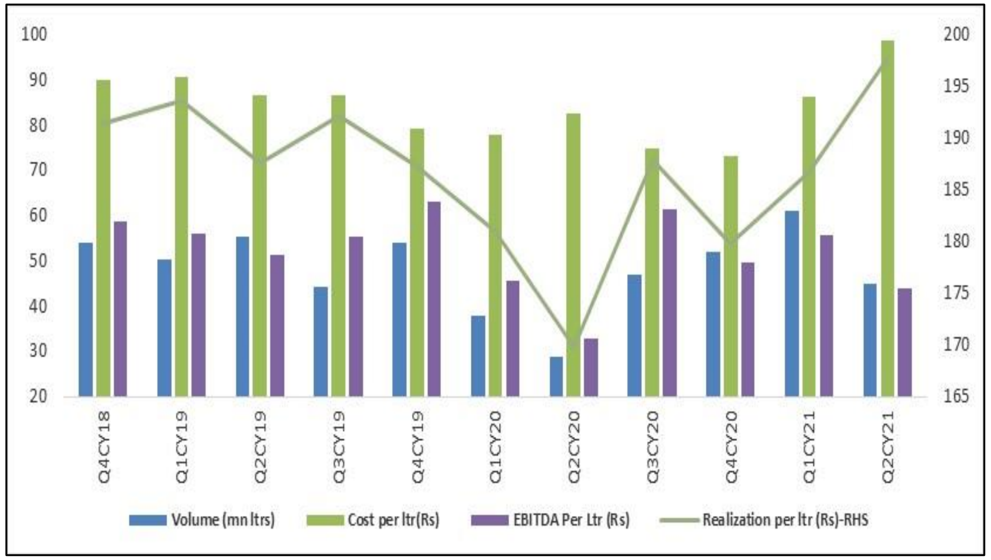
Key updates

Expectation of more volume recovery due to relaxation of lockdown

Castrol's volume declined sequentially to 45 mn ltr in Q2CY21 as the nationwide lockdown has impacted demand for lubricants across the automotive and industrial segments. However, it grew on YoY basis from 28.9 mn ltr in Q2CY20. Now, Government has started to implement initial phases of unlock as per the local 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. H1CY21 has seen a sharp rise in volume growth at more than ~58% though on a low base, and we expect recovery in volume growth to continue in H2CY21.

Besides, realization per ltr increased to Rs 197.7 in Q2CY21 vs. Rs 186.7 in Q1CY21 and Rs 169.8 in Q2CY20. We expect Castrol's lubricants volume to increase by 26.8% led by lower base effect and it could increase by 3% and 4.5% in CY22 and CY23, respectively.

Volume and per litre data



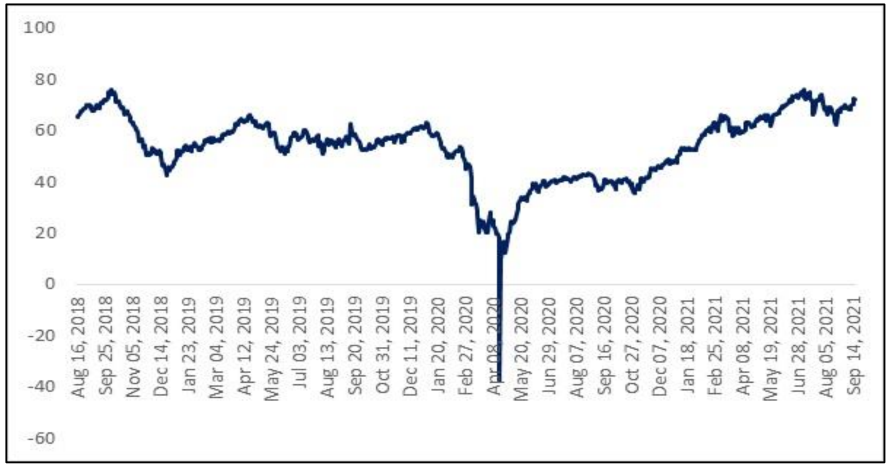
Lower crude oil price to expand its margins

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 in Q2CY21. Castrol's 2QCY21 unit realizations increased by ~6% Q0Q to Rs197.7/liter from Rs186.7/liter reflecting benefits of pricing interventions taken in April 2021. Unit RM cost increased 15% to Rs98.9/liter, albeit at a slower pace than the rise in base oil prices.

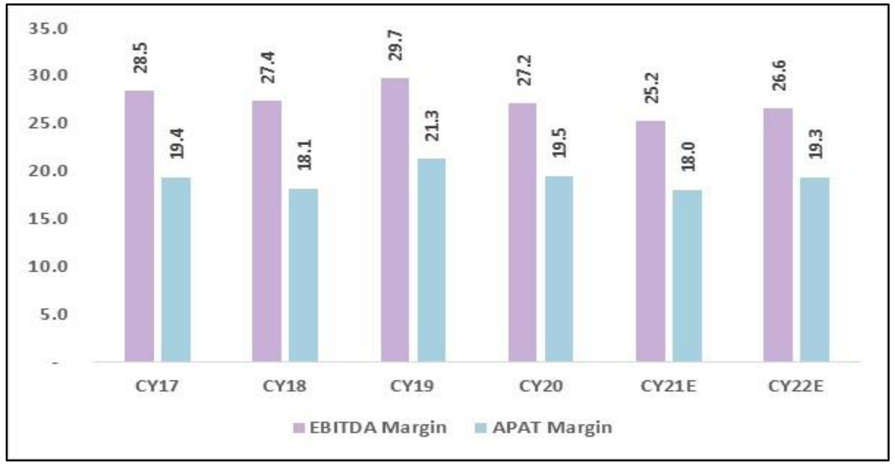
With the falling trend in crude oil prices, raw material costs (base oil prices) are not expected to remain soft, aiding the improvement in margins. Oil price forecasts depend on the interaction between supply and demand for oil in international markets. The most important supply-side factors impacting pricing in the next few years are expected to include US shale oil production, US crude oil stocks, and OPEC oil supply. As per the forecast of US Energy Information Administration, Brent crude oil prices will average $62.26 per barrel in 2021 and $60.74 per barrel in 2022 according to the forecast in the most recent Short-Term Energy Outlook. The International Monetary Fund, in its latest release of the World Economic Outlook, predicts a similar recovery scenario, with Brent oil prices rising to US$59.74 per barrel in 2021 and then to $56.23 in 2022.

If the Brent crude price sustains in the range of USD 55-60/bbl and as new base oil capacities are commissioned globally, base oil prices could fall further, increasing Castrol's gross margins. However in Q3CY21, crude prices are on an uptrend so far.

Crude Oil Prices- US$/bbl



Margins-%



(Source: Company, HDFC sec Research)

Strategic partnership with Auto companies, expanding distribution network to add incremental volume growth

Castrol India has been engaging with OMC and auto manufacturers to sell and develop its products over the periods. The company has entered into strategic partnerships with Ford India, Honda two-wheelers, Jawa Motorcycles, Renault India and Honda Motorcycle & Scooter India Pvt. Ltd. The alliance for supply of exclusive after sales engine oil lubricants are an extension of a global strategic partnership between these auto manufacturers and Castrol. Recently, the company Management launched Castrol Express Oil change outlets at two Jio-BP retail sites to leverage the partnership further. It also signed a three-year deal with Mahindra Choice for presence at their workshops.

During the COVID pandemic, the company has seen an impact on demand and volume declined in Q2CY20. However, despite the second wave and subsequent impact on demand, Castrol is focused on expanding its network and presence. With increasing presence via partnerships, a wider reach could further help to generate incremental volume going forward.

Highly focused in new launch and promotion of products

Castrol is keeping a close watch on developments in new technologies based products as well as electric vehicles and preparing response plans to address these for the long term. The company continued to drive premiumisation and synthetisation in the personal mobility segment, despite a challenging operating context.

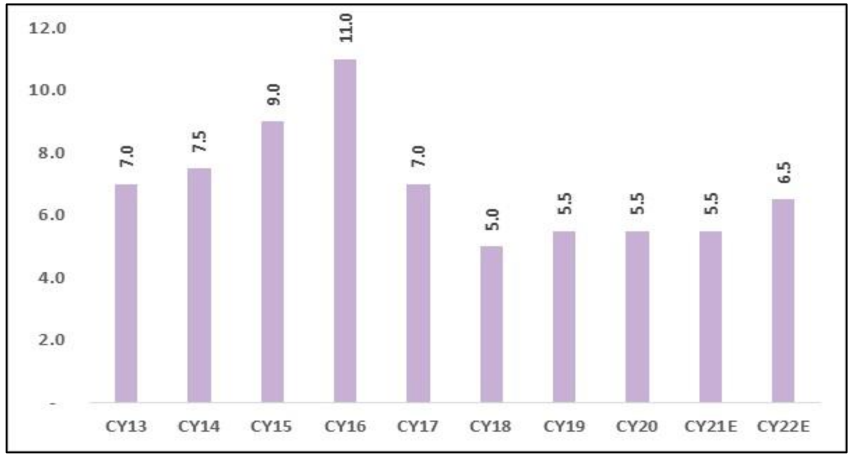
The company pursued growth opportunities and launched new products for cruiser bikes (Castrol Activ Cruise) and full synthetic performance oils in the premium segment for two wheelers (Castrol POWER1 ULTIMATE). In car oils, the Company drove synthetic products across mass and premium segments and launched Castrol GTX SUV oils for sports utility vehicles. It also ran a digital brand campaign for Castrol MAGNATEC SUV supplemented through on-ground mechanic engagements. In commercial vehicle oils, the company promoted Castrol CRB TURBOMAX with presence in mass media and engagement with mechanics virtually as well as through ground activations. It also stayed connected with farmers through local rural activations.

While the company continued working in close association with its strategic OEM partners, it leveraged new channels like the Jio-bp retail network and the independent workshop channel, further increasing its footprint nationally.

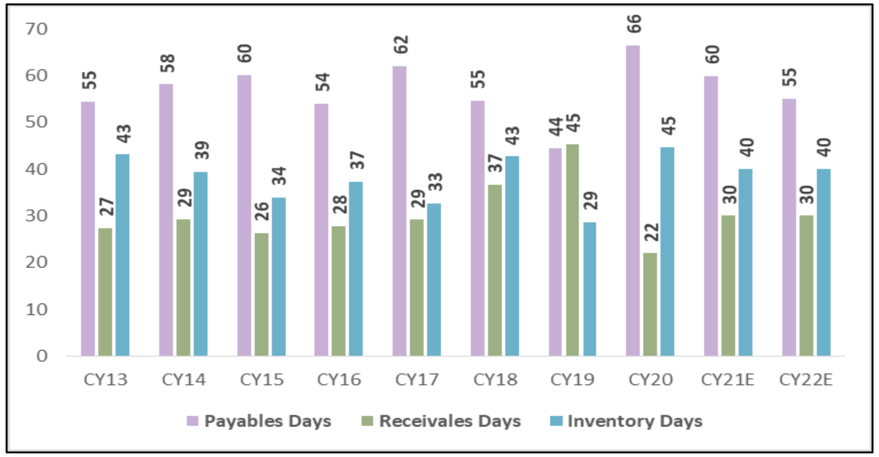
Strong fundamentals supported by healthy liquidity, zero debt and high dividend payout

- Castrol financial profile has been robust led by debt free balance sheet, healthy cash generating ability and consistent dividend payment to shareholders over the past. Financial flexibility is strong, supported by robust liquidity.
- Castrol’s revenues from operations rose from Rs 2993 crore (CY11) to Rs 3877 crore (CY19) - ~4% CAGR over the period and CY20 was an exceptional year, due to Covid pandemic and revenue stood at Rs 2,997 crore. The Company reported EBITDA margin at a range of 26-30% and PAT margin at a range of 18.5-21% over the last six 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, improved product quality requiring late replacement of lubes and electrification of vehicles in India.
- The company has zero debt to equity status and the company has no further plan to raise any debt going forward. The company has sufficient cash and cash equivalent for further investment to expand its business going forward. As on 30th June, 2021, the company has cash and cash equivalent of Rs 1162 crore and free cash flow to Enterprise value stood at 8.3% in CY20 vs 7.4% in CY19.
- Castrol is also expected to invest in niche acquisitions to strengthen its domain expertise in the medium term. These will be largely funded from its cash surplus and healthy accruals.

Dividend per share (Rs)



Working Capital Days (Nos)



(Source: Company, HDFC sec)

- The company has always been generous in declaring dividend, the company has a track record of consistent on dividend payout to its shareholders over the periods. The dividend payout amounts to close to ~75% of the post-tax profit and dividend yield (based on CY20 dividends) stands at 4.7%.
- The 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, impacted by COVID pandemic and the payable increased from 44 days to 66 days, as on 31st Dec 2020. It indicates good bargaining power with suppliers and the receivable days have decreased to 22 days from 45 days in CY19.
- Rise in profitability as well as better return ratios in the future, we expect RoE at 49.4% and 48.1% in CY21E and CY22E, respectively.

What could go wrong?

- Stiff 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.
- Supply disruptions on account of base oil and raw materials availability, logistics challenges and rupee depreciation are likely to adversely impact demand and supply.
- There is normal 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.

- Significant INR depreciation could impact the growth of Company as the raw material is priced based on import parity in local Rupees.
- Crude oil prices are now on the up. 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. In Hybrid/Electrical vehicles, Castrol is working on building the efficiency of the electrical motor and reducing the risk of electrical breakdowns by optimizing the electrical properties of the gear oil, preventing corrosion of electrical components through good protection of copper parts and improving the cooling capabilities of the electrical engine to prevent overheating. While Castrol is riding on parent BP's early moves into developing specialised lubricants for EVs, that are much pricier, the risk of the loss of business from ICE not being offset by the lower volume, but higher realisation EV lubricants remains. However Castrol has signed agreements with MG Motors and Tata Motors for the supply of EV fluids in India. The company expects it would be another 15–20 years before a scalable EV fleet is seen on Indian roads.

Change in Estimates

Rs in Cr	CY21E		CY22E
	Old	New	New
Revenue	3738	4170	4424
EBITDA	723	1052	1177
APAT	841.5	750	855
EPS	9.1	7.6	8.6

Peer comparison

Company, Rs in Cr	Mkt Cap, Cr	Sales			EBITDA			PAT			ROE-%			P/E (x)		
		CY20	CY21E	CY22E	CY20	CY21E	CY22E	CY20	CY21E	CY22E	CY20	CY21E	CY22E	CY20	CY21E	CY22E
Castrol	**13482**	**2997**	**4170**	**4424**	**814**	**1052**	**1177**	**583**	**750**	**855**	**41.9**	**50.3**	**51.0**	**23.2**	**18.0**	**15.8**
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Gulf Oil Lubricant	3099	1652	1841	1980	265	272	298	200	204	220	24.6	22.2	21.4	15.4	15.1	14.0

Financials (Consolidated)

Income Statement

(Rs Cr)	CY18	CY19	CY20	CY21E	CY22E
Net Revenues	**3905**	**3877**	**2997**	**4170**	**4424**
Growth (%)	9.4	-0.7	-22.7	39.1	6.1
Operating Expenses	2834	2724	2183	3118	3247
EBITDA	**1071**	**1153**	**814**	**1052**	**1177**
Growth (%)	5.2	7.7	-29.4	29.3	11.8
EBITDA Margin (%)	**27.4**	**29.7**	**27.2**	**25.2**	**26.6**
Depreciation	56	70	87	88	91
EBIT	**1015**	**1083**	**728**	**964**	**1086**
Other Income	84	65	62	67	73
Interest expenses	1	1	4	3	3
PBT	**1098**	**1147**	**785**	**1028**	**1156**
Tax	390	320	202	278	301
RPAT	**708**	**827**	**583**	**750**	**855**
Growth (%)	**2.4**	**16.8**	**-29.6**	**28.7**	**14.0**
EPS	7.2	8.4	5.9	7.6	8.6

Balance Sheet

As at Dec	CY18	CY19	CY20	CY21E	CY21E
SOURCE OF FUNDS					
Share Capital	495	495	495	495	495
Reserves	671	872	920	1077	1289
Shareholders' Funds	**1166**	**1367**	**1414**	**1571**	**1784**
Long Term Debt	0	0	0	0	0
Net Deferred Taxes	-53	-59	-62	-65	-69
Long Term Provisions & Others	16	21	33	33	33
Minority Interest	**0**	**0**	**0**	**0**	**0**
Total Source of Funds	**1128**	**1330**	**1385**	**1539**	**1748**
APPLICATION OF FUNDS					
Net Block	186	200	209	211	205
CWIP	35	27	44	46	48
Other Non-Current Assets	106	108	135	142	149
Total Non Current Assets	**327**	**335**	**388**	**399**	**402**
Inventories	457	305	367	457	485
Trade Receivables	392	482	181	343	364
Cash & Equivalents	744	946	1274	1297	1427
Other Current Assets	134	103	122	110	99
Total Current Assets	**1727**	**1836**	**1944**	**2206**	**2375**
Short-Term Borrowings	0	0	0	0	0
Trade Payables	584	472	546	685	667
Other Current Liab & Provisions	341	369	401	381	362
Total Current Liabilities	**925**	**840**	**947**	**1066**	**1029**
Net Current Assets	801	995	997	1140	1346
Total Application of Funds	**1128**	**1330**	**1385**	**1539**	**1748**

Cash Flow Statement

(Rs Cr)	CY18	CY19	CY20	CY21E	CY22E
Reported PBT	1,098	1,147	785	1,028	1,156
Non-operating & EO items	-57	-42	-48	-18	-17
Interest Expenses	1	1	4	3	3
Depreciation	56	70	87	88	91
Working Capital Change	-149	13	304	-112	-68
Tax Paid	-400	-309	-240	-278	-301
OPERATING CASH FLOW (a)	**549**	**880**	**893**	**711**	**864**
Capex	-78	-99	-42	-90	-85
Free Cash Flow	472	780	851	621	779
Investments	92	-398	-201	0	0
Non-operating income	52	49	42	12	11
INVESTING CASH FLOW (b)	**66**	**-448**	**-201**	**-78**	**-74**
Debt Issuance / (Repaid)	0	0	0	0	0
Interest Expenses	-1	-1	-4	-3	-3
FCFE	470	779	847	618	776
Share Capital Issuance	0	0	0	0	0
Dividend	-566	-627	-543	-544	-643
FINANCING CASH FLOW (c)	**-567**	**-628**	**-548**	**-547**	**-646**
NET CASH FLOW (a+b+c)	**48**	**-196**	**144**	**85**	**144**

Key Ratios

(Rs Cr)	CY18	CY19	CY20	CY21E	CY22E
EBITDA Margin (%)	27.4	29.7	27.2	25.2	26.6
EBIT Margin (%)	26.0	27.9	24.3	23.1	24.5
APAT Margin (%)	18.1	21.3	19.5	18.0	19.3
RoE (%)	64.8	65.3	41.9	50.3	51.0
RoCE (%)	85.1	78.7	50.5	59.4	59.1
Solvency Ratio (x)					
Debt/EBITDA	0.0	0.0	0.0	0.0	0.0
D/E	0.0	0.0	0.0	0.0	0.0
PER SHARE DATA (Rs)					
EPS	7.2	8.4	5.9	7.6	8.6
CEPS	7.7	9.1	6.8	8.5	9.6
BV	11.8	13.8	14.3	15.9	18.0
Dividend	5.0	5.5	5.5	5.5	6.5
Turnover Ratios (days)					
Debtor days	36.6	45.4	22.0	30.0	30.0
Inventory days	42.7	28.7	44.7	40.0	40.0
Creditors days	54.6	44.4	66.4	60.0	55.0
VALUATION (x)					
P/E	19.1	16.3	23.2	18.0	15.8
P/BV	11.6	9.9	9.5	8.6	7.6
EV/EBITDA	11.9	10.9	15.0	11.6	10.3
EV / Revenues	3.3	3.2	4.1	2.9	2.7
Dividend Yield (%)	3.7	4.0	4.0	4.0	4.8
Dividend Payout (%)	83.8	78.9	76.4	79.1	75.2

One Year Stock Price Chart

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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