

Castrol (India)

Estimate change	↔
TP change	↔
Rating change	↔

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Bloomberg	CSTR IN
Equity Shares (m)	989
M.Cap.(INRb)/(USD\$b)	116.1 / 1.5
52-Week Range (INR)	162 / 90
1, 6, 12 Rel. Per (%)	-9/8/-3
12M Avg Val (INR M)	240

Financials & Valuations (INR b)

Y/E December	2019	2020E	2021E
Sales	38.8	29.5	37.1
EBITDA	11.5	10.6	12.6
Adj. PAT	8.3	7.8	9.2
Adj. EPS (INR)	8.4	7.8	9.3
EPS Gr. (%)	16.8	-6.3	18.3
BV/Sh.(INR)	13.8	15.1	16.6

Ratios

Net D:E	-0.7	-0.8	-0.8
RoE (%)	65.3	54.2	58.5
RoCE (%)	65.4	54.3	58.6
Payout (%)	78.9	83.8	83.8

Valuations

P/E (x)	14.0	14.9	12.6
P/BV (x)	8.5	7.8	7.0
EV/EBITDA (x)	9.2	9.9	8.1
Div. Yield (%)	4.7	4.7	5.5
FCF Yield (%)	7.2	7.4	8.5

Shareholding pattern (%)

As On	Mar-20	Dec-19	Mar-19
Promoter	51.0	51.0	51.0
DII	18.3	17.6	17.3
FII	11.8	12.2	11.2
Others	18.8	19.2	20.6

FII Includes depository receipts

CMP: INR117

TP: INR185 (+58%)

Buy

Huge COVID-led impact on demand; expect lag in revival

- The second half of March, which delivers significant volumes for the company every year, recorded decline much before the lockdown came into effect (on 23rd Mar). Also, Jan and Feb saw some softness in macro datasets, which thus impacted overall demand for the quarter (it stood at 37.6mn lit, -25% YoY).
- However, realization was lower 6% YoY, with a flattish YoY gross margin.
- The company expects demand to be lower over the next few months as the economy would take time to revive. It aims to continue focusing on a better product mix, cost optimization initiatives, and the Personal Mobility segment as these would aid margins in the tepid manufacturing growth environment.
- CSTR has always enjoyed its brand equity heritage, and we believe it would continue to do so. The company has reiterated it would take pricing action whenever necessary to maintain lucrative margins in line with the competition.
- CSTR is expected to have strong FCF generation of INR8–10/share each in the next two years, implying FCF yield of 7.4–8.5%. Also, it has been increasing its dividend since the last three years, which translates into attractive dividend yield of ~5%. **Maintain Buy.**

Miss on estimates due to poor volumes

- Due to the aforementioned impact of COVID-19, CSTR's 1QCY20 volumes were disappointing at 37.6m liters (-25% YoY, -30% QoQ). On the other hand, realization was lower at INR183/liter (-6% YoY), thus resulting in net sales of INR6.9b (-30% YoY).
- The gross margin stood at INR104.4/liter (+1% YoY), while EBITDA came in at INR1.7b (-39% YoY). PAT was at INR1.25b (-32% YoY), with the tax rate at 26.1% during the quarter.

Volume outlook – expect lag in recovery

- Owing to the implementation of lockdown nationwide, the company's three plants (Patalganga, Silvassa, and Paharpur) were closed since 23rd Mar'20, but commenced partial operations in May'20.
- The company expects lower demand for the next couple of months as the economy revives. It believes pent-up demand may witness a lag as customers defer their servicing demand (due to a lower purchasing power).
- April was under complete shutdown, while May saw some demand from Agriculture, albeit much lower YoY.
- A gradual pickup is being witnessed in demand for two-wheelers as the lockdown is lifted.

Strong strategic developments continue

- During the quarter, CSTR renewed its long-term partnership with JCB.
- The company has signed various supply agreements for BS-VI compliant lubricants with OEMs in India.
- It has also entered into agreements for the supply of EV fluids with MG Motors and Tata Motors. However, CSTR expects it would be another 15–20 years before a scalable EV fleet is seen on Indian roads.

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Focus on PCMO to drive growth; better product mix to aid margins

- The company is also working on new product launches; however, it remains subject to normalization in the current environment.
- Nevertheless, margins are expected to improve with a better product mix (e.g., BS-VI is thinner oil, so margins would improve). The company has announced various BS-VI products across categories, which would be at a premium for improved quality; it would also be backward compatible (i.e., would be usable even in BSIV engines).
- Personal Mobility continues to remain strong, constituting ~40% of the total sales mix (with Industrial and Commercial accounting for the rest). Also, India is a growth economy and revival in PCMO car sales would further lead to new/net sales volumes for the company. CSTR has guided it would continue to focus and invest in Personal Mobility (investments have resulted in a 7% CAGR over the last decade). This is as PCMO is more profitable than B2B segments.

Valuation and view

- In the last quarter, the company had guided for maintaining similar levels of dividend policy; it would also continue to invest in distribution, brand, and advocacy to gain lost market share.
- However, factoring the COVID-19 impact on volumes, we have built-in volume decline of 20% in CY20 to 163m lit. and normalization in volumes at 196m lit. in CY21 (similar to CY19 levels). Furthermore, the gross margin would be stable at ~INR115/lit. (v/s INR109 in CY19), primarily due to the benefit of lower crude prices. We model realization at INR181 per liter / INR190 per liter (-5%/+5%) for CY20/CY21 (v/s INR190/lit in CY19).
- The stock trades at 14.9x CY20 EPS of INR7.8 and EV/EBITDA of 9.9x, with an EBITDA CAGR of 5% (CY19–21). Current dividend yield is 4.7%.
- We value the stock at 20x (in line with global peers) to arrive at a target price of INR185. Maintain **Buy**.

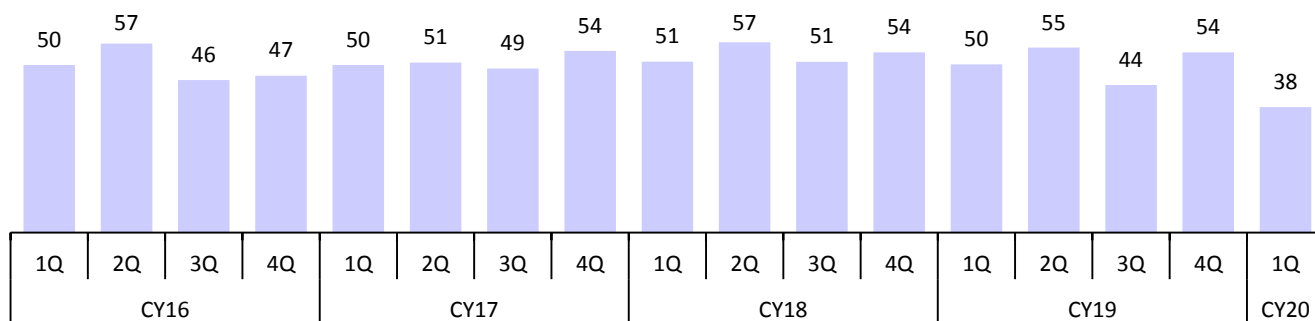
Quarterly Performance

Y/E December	CY19				CY20				CY19	CY20E	CY20 1QE
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
Volume (m liters)	50.4	55.4	44.2	54.0	37.6	27.7	44.2	53.7	204	163	51.4
Realization	194	188	192	187	183	178	183	178	190	181	200
Net Sales	9,762	10,396	8,492	10,118	6,880	4,938	8,067	9,578	38,768	29,464	10,057
YoY Change (%)	5.3	2.2	-8.4	-2.1	-29.5	-52.5	-5.0	-5.3	-0.7	-24.0	3.0
EBITDA	2,830	2,843	2,445	3,412	1,730	1,393	3,376	4,061	11,530	10,560	3,269
YoY Change (%)	3.2	13.0	7.5	7.5	-38.9	-51.0	38.1	19.0	7.7	-8.4	15.5
Margins (%)	29.0	27.3	28.8	33.7	25.1	28.2	41.8	42.4	29.7	35.8	32.5
Depreciation	162	166	186	183	222	191	213	174	697	800	186
Interest	3	3	3	3	11	3	3	-6	12	10	3
Other Income	211	159	116	162	198	151	110	156	648	615	216
PBT	2,876	2,833	2,372	3,388	1,695	1,351	3,270	4,049	11,469	10,364	3,297
Rate (%)	35.7	35.5	20.6	19.9	26.1	25.2	25.2	24.8	27.9	25.2	25.2
PAT	1,850	1,827	1,884	2,713	1,252	1,010	2,446	3,045	8,274	7,753	2,466
YoY Change (%)	1.8	11.3	25.3	28.0	-32.3	-44.7	29.8	12.2	16.8	-6.3	33.3
Operational Details (INR/lit.)											
Volume (m liters)	50.4	55.4	44.2	54.0	37.6	27.7	44.2	53.7	204.0	163.2	51.4
Realization	193.7	187.7	192.1	187.4	183.0	178.3	182.5	178.4	190.0	180.5	195.6
Gross margin	103.1	101.2	105.4	108.1	104.4	124.8	118.6	113.9	104.4	114.8	103.7
EBITDA	56.2	51.3	55.3	63.2	46.0	50.3	76.4	75.6	56.5	64.7	63.6
PAT	36.7	33.0	42.6	50.2	33.3	36.5	55.3	56.7	40.6	47.5	48.0

Other highlights

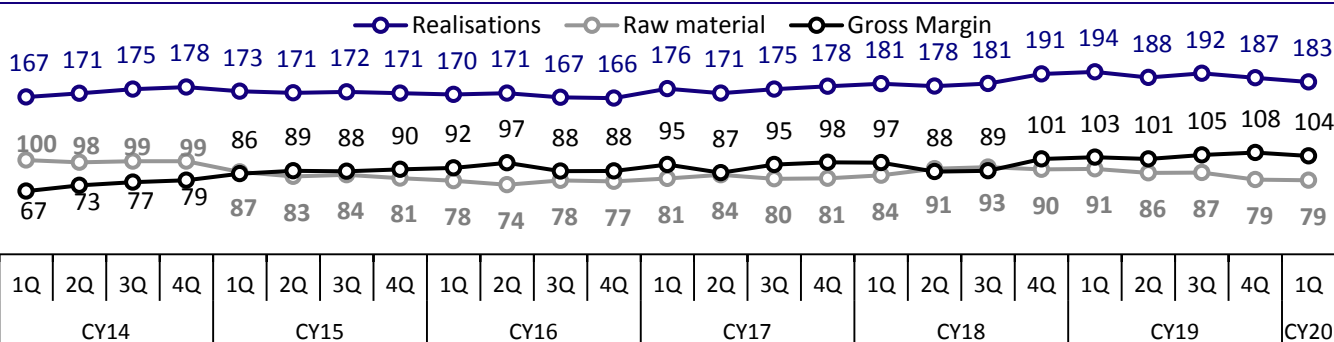
- CSTRL has already launched the BS-VI ready range of products across categories, which could also be used in BS-III/IV vehicles. This range includes Castrol VECTON Long Drain 15W40 CK4 commercial vehicle engine oil, which is certified carbon-neutral and powers trucks with an extended drain interval of up to 120k kilometers.
- Oil drain intervals are expected to rise in the Commercial segment for BSVI engines; however, BSVI products would be at a premium for improved quality and would also be backward compatible (i.e., usable in even BSIV engines).
- CSTRL launched EV fluids globally (China and Europe), and in 1QCY20, it signed agreements with MG Motors and Tata Motors for the supply of EV fluids. However, CSTRL expects it would be another 15–20 years before a scalable EV fleet is seen on Indian roads.
- In light of the possible onslaught by electric vehicles, the company is looking at different revenue streams for the future. The recent deal with 3M is a reflection of the company's diversification plans into new avenues. However, CSTRL accounts for ~30% of the total volumes in the 2Ws segment, which may be hugely impacted by EVs.
- Due to the oligopoly nature of the market (Lubrizol, Infineum, Oronite, and Afton), additive prices keep going up. With more launches, the premium of synthetic lube is likely to reduce.
- On a one-year forward PE basis, the stock trades at a ~50% discount to its LT PE average of 28.3x (around -1SD).

Exhibit 1: Castrol's volume (m liters) declined 25.4% YoY and 30.4% YoY to 37.6m lit.



Source: Company, MOFSL

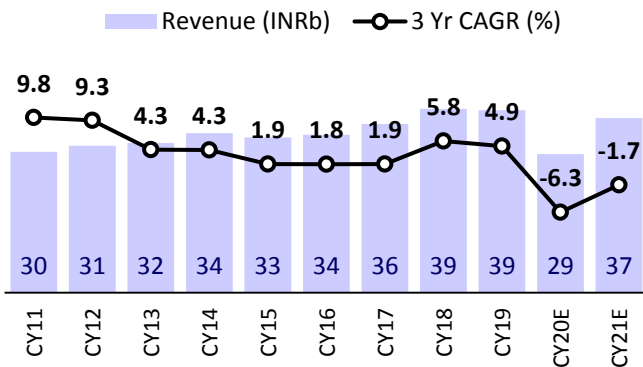
Exhibit 2: Realization declined marginally to INR183/liter, with raw material cost at -13.3% YoY and flat QoQ



Source: Company, MOFSL

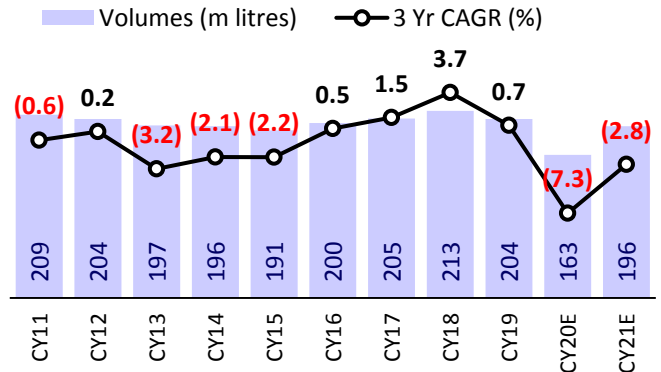
Story in charts

Exhibit 3: Castrol's revenue is expected to be flat in CY21...



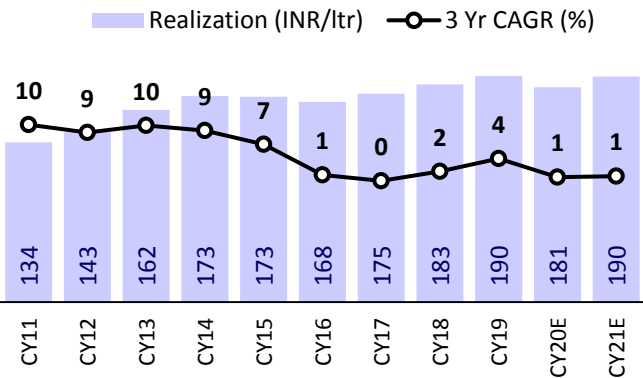
Source: Company, MOSL

Exhibit 4: ...led by impact of COVID-19 on growth in CY20



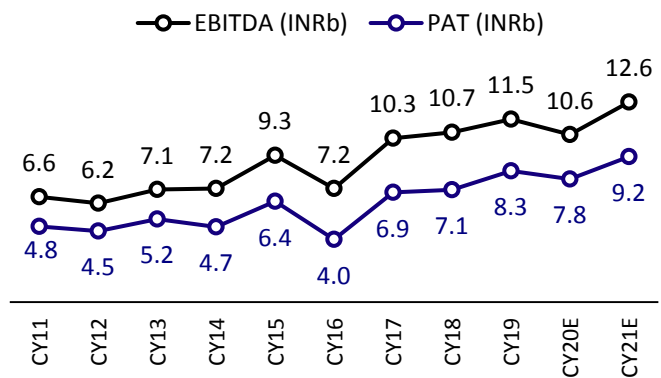
Source: Company, MOSL

Exhibit 5: While realizations are set to decline marginally...



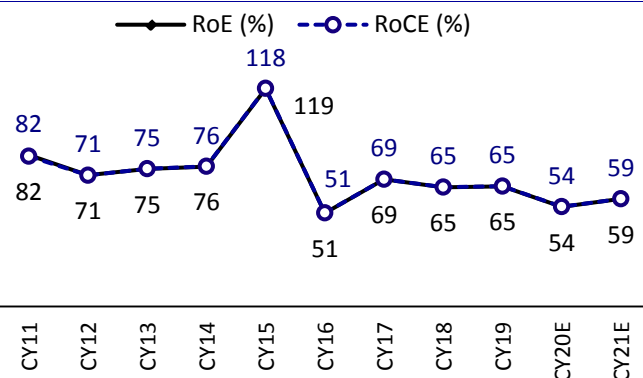
Source: Company, MOSL

Exhibit 6: EBITDA growth would be ~5% over the next two years



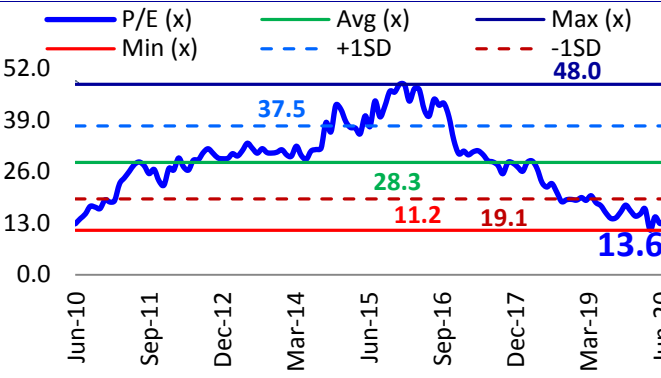
Source: Company, MOSL

Exhibit 7: Return ratios are expected to remain strong



Source: Company, MOSL

Exhibit 8: Castrol trades below its -1SD at 13.6x



Source: Company, MOSL

Financials and Valuations

Standalone - Income Statement

(INR m)

Y/E December	CY14	CY15	CY16	CY17	CY18	CY19	CY20E	CY21E
Net sales	33,923	32,980	33,580	35,843	39,046	38,768	29,464	37,124
Change (%)	6.7	-2.8	1.8	6.7	8.9	-0.7	-24.0	26.0
Gross Margin	14,548	16,972	15,499	19,183	19,980	21,291	18,739	22,414
Margin (%)	42.9	51.5	46.2	53.5	51.2	54.9	63.6	60.4
Total Expenditure	26,756	23,726	26,420	25,513	28,338	27,238	18,904	24,517
EBITDA	7,167	9,255	7,160	10,330	10,708	11,530	10,560	12,607
Margin (%)	21.1	28.1	21.3	28.8	27.4	29.7	35.8	34.0
Depreciation	361	390	450	455	556	697	800	915
EBIT	6,806	8,865	6,710	9,875	10,152	10,833	9,759	11,693
Interest Charges	24	8	15	12	11	12	10	8
Other Income	481	959	969	837	843	648	615	578
PBT bef. EO Exp.	7,263	9,816	7,664	10,700	10,984	11,469	10,364	12,262
EO Items	0	306	0	0	0	0	0	0
PBT after EO Exp.	7,263	9,510	7,664	10,700	10,984	11,469	10,364	12,262
Income tax	2,518	3,357	3,708	3,782	3,901	3,195	2,612	3,090
Tax Rate (%)	34.7	35.3	48.4	35.3	35.5	27.9	25.2	25.2
Reported PAT	4,746	6,153	3,956	6,918	7,083	8,274	7,753	9,172
Adjusted PAT	4,746	6,351	3,956	6,918	7,083	8,274	7,753	9,172
Change (%)	-9.4	33.8	-37.7	74.9	2.4	16.8	-6.3	18.3
Margin (%)	14.0	19.3	11.8	19.3	18.1	21.3	26.3	24.7

Standalone - Balance Sheet

(INR m)

Y/E December	CY14	CY15	CY16	CY17	CY18	CY19	CY20E	CY21E
Equity Share Capital	2,473	2,473	2,473	4,946	4,946	4,946	4,946	4,946
Total Reserves	2,495	3,283	7,343	5,256	6,711	8,724	9,983	11,473
Net Worth	4,968	5,756	9,816	10,202	11,657	13,670	14,929	16,418
Capital Employed	4,968	5,756	9,816	10,202	11,657	13,670	14,929	16,418
Gross Block	3,762	3,915	4,004	4,404	5,440	6,267	7,067	7,567
Less: Accum. Deprn.	2,041	2,427	2,585	3,040	3,596	4,293	5,093	6,007
Net Fixed Assets	1,721	1,488	1,419	1,364	1,844	1,974	1,974	1,559
Capital WIP	157	364	423	599	366	296	800	500
Curr. Assets, Loans&Adv.	12,426	14,265	16,369	17,255	18,325	19,433	18,930	23,085
Inventory	3,655	3,046	3,439	3,196	4,568	3,047	2,382	3,090
Account Receivables	2,715	2,365	2,552	2,850	3,918	4,820	2,341	2,950
Cash and Bank Balance	4,315	6,965	8,219	7,842	7,438	9,461	11,555	13,704
Loans and Advances	1,742	1,889	2,159	3,367	2,401	2,105	2,652	3,341
Curr. Liability & Prov.	9,954	10,860	9,067	9,568	9,411	8,618	7,360	9,311
Account Payables	5,492	5,645	4,966	6,066	5,840	4,718	4,506	5,844
Other Current Liabilities	1,377	1,457	3,478	2,967	3,111	3,403	2,357	2,970
Provisions	3,084	3,758	623	535	460	497	497	497
Net Current Assets	2,472	3,404	7,302	7,687	8,914	10,815	11,570	13,774
Deferred Tax assets	618	499	672	551	533	585	585	585
Appl. of Funds	4,968	5,756	9,816	10,201	11,657	13,670	14,929	16,418

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E December	CY14	CY15	CY16	CY17	CY18	CY19	CY20E	CY21E
Basic (INR)								
EPS	4.8	6.4	4.0	7.0	7.2	8.4	7.8	9.3
Cash EPS	5.2	6.8	4.5	7.5	7.7	9.1	8.6	10.2
BV/Share	5.0	5.8	9.9	10.3	11.8	13.8	15.1	16.6
DPS	3.8	4.5	5.5	4.7	5.0	5.5	5.5	6.5
Payout (%)	92.7	87.1	165.5	81.5	83.8	78.9	83.8	83.8
Valuation (x)								
P/E		18.2	29.3	16.7	16.3	14.0	14.9	12.6
Cash P/E		17.2	26.3	15.7	15.1	12.9	13.5	11.5
P/BV		20.1	11.8	11.3	9.9	8.5	7.8	7.0
EV/Sales		3.3	3.2	3.0	2.8	2.7	3.5	2.7
EV/EBITDA		11.8	15.0	10.4	10.1	9.2	9.9	8.1
Dividend Yield (%)	3.2	3.8	4.7	4.1	4.3	4.7	4.7	5.5
FCF per share	5.8	8.1	1.2	6.2	5.3	8.4	8.7	9.9
Return Ratios (%)								
RoE	76.0	118.4	50.8	69.1	64.8	65.3	54.2	58.5
RoCE	76.2	118.5	50.9	69.2	64.9	65.4	54.3	58.6
Working Capital Ratios								
Asset Turnover (x)	6.8	5.7	3.4	3.5	3.3	2.8	2.0	2.3
Inventory (Days)	39	34	37	33	43	29	30	30
Debtor (Days)	25	23	24	25	32	39	25	25
Creditor (Days)	59	62	54	62	55	44	56	57
Leverage Ratio (x)								
Net Debt/Equity	-0.9	-1.2	-0.8	-0.8	-0.6	-0.7	-0.8	-0.8

Standalone - Cash Flow Statement

(INR m)

Y/E December	CY14	CY15	CY16	CY17	CY18	CY19	CY20E	CY21E
OP/(Loss) before Tax	7,263	9,816	7,664	10,700	10,984	11,469	10,364	12,262
Depreciation	361	390	450	455	556	697	800	915
Interest & Finance Charges	24	8	15	12	11	12	10	8
Direct Taxes Paid	-2,518	-3,357	-3,708	-3,782	-3,901	-3,195	-2,612	-3,090
(Inc)/Dec in WC	1,131	1,718	-2,644	-762	-1,631	122	1,339	-55
CF from Operations	6,262	8,575	1,777	6,623	6,019	9,105	9,902	10,040
CF from Operating incl EO	6,174	8,388	1,605	6,744	6,037	9,053	9,902	10,040
(Inc)/Dec in FA	-485	-365	-440	-576	-803	-757	-1,304	-200
Free Cash Flow	5,688	8,023	1,165	6,168	5,234	8,296	8,598	9,840
CF from Investments	-485	-365	-440	-576	-803	-757	-1,304	-200
Interest Paid	-24	-8	-15	-12	-11	-12	-10	-8
Dividend Paid	-4,399	-5,357	-6,547	-5,637	-5,935	-6,528	-6,494	-7,683
CF from Fin. Activity	-7,316	-5,373	89	-6,544	-5,639	-6,273	-6,504	-7,691
Inc/Dec of Cash	-1,628	2,651	1,254	-377	-405	2,023	2,094	2,149
Opening Balance	5,942	4,315	6,965	8,219	7,842	7,438	9,461	11,555
Closing Balance	4,315	6,965	8,219	7,842	7,437	9,461	11,555	13,704

E: MOSL Estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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