

Institutional Equity Research

Castrol India

OIL & GAS | India

Initiating Coverage | 21 October 2020

CMP* (Rs)	112
Upside/ (Downside) (%)	51
Bloomberg Ticker	CSTRL IN
Market Cap. (Rs bn)	111
Free Float (%)	49
Shares O/S (mn)	989

BUY 

2-Year Target Price: Rs.169

Compelling Valuation & Counting on Dividend Support

Key Triggers

- India is the world's 3rd largest lubricants market with ~ 2.7bn litre of annual consumption
- Castrol is No.1 private player with ~12% market share, while the OMCs enjoy ~45% market share
- Castrol's volume is expected to clock 2.5% CAGR over CY19-CY22E
- Premiumisation and power brands are expected to drive realization and margin
- Inexpensive valuation compared to FMCG players

- Despite the impact of COVID-19 in the short-term, Castrol India (CSTRL) has maintained long-term volume growth guidance of 5-6% per year. We expect Castrol's volume to clock 2.5% CAGR over CY19-CY22E backed by: higher pent-up demand for vehicle repairing/servicing in 2HCY20, sustainable volume growth opportunity owing to RIL-BP JV, strategic alliances with auto majors, faster demand recovery in rural markets, digital technology and vast pan-India distribution network.
- Average crude oil price of CY20 is most likely to be the lowest point of the decade. There is a strong (92%) correlation between crude oil prices and base oil prices from 1998 till CY20TD (in USD terms). Based on 1-year forward curve and Bloomberg estimate, the Brent prices are seen at US\$42, US\$45 and US\$50 for CY20, CY21 and CY22, respectively. We expect CSTRL to get benefited from soft base oil prices and likely to post better gross margin, going forward. Its gross margin is expected to improve from 55% (CY19) to 58%, 59% and 59% in CY20, CY21 and CY22, respectively.
- Castrol continues to remain at the helm of brand recall with its realization clocking 4% CAGR over last 3 years. We expect its blended realisation to keep on increasing, which would drive margin. Despite a blip in CY20, we expect Castrol's realization to recover, going forward on likely price revision in CY21, and touch the CY19-level in CY22E.

ESG Analysis: While analyzing 20 key criteria (10 points each) under ESG Matrix, we have assigned an overall score of 61% to CSTRL. Under **"Environmental Head"**, we have assigned a 45% score, as the company is into the manufacturing of lubricants which pose a great danger to the environment. Under **"Social Head"**, we have assigned 66% score, as the company has received many awards/accolades for its customer excellence, due representation of women in a managerial position and CSR spend. Under **"Governance Head"**, we have assigned a 68% score, as it's a part of BP Group, which maintains a very high standard for corporate governance (please refer to page no 4. for detailed ESG analysis).

Outlook & Valuation

Castrol traded at an average 1-yr forward PE of 23x over CY17-20TD. At CMP, the stock trades at 10.6x CY22 EPS of Rs10.6 and EV/EBITDA of 6.6x (CY22) with EBITDA CAGR of 6% (CY19-22). Current dividend yield is ~5%. Due to lubricant players' similarity to FMCG companies in terms of financial metrics and consumer centric business, we have compared Castrol with FMCG peers and observed that it trades at 70% discount to FMCG players. The average RoE of FMCG proxy universe is ~50%, while PE multiple is 38x (consensus). Moreover, we have also calculated theoretical PE (dividend discount model), which is 15.6x for CY22E earnings. Hence, we are comfortable with our 16x target PE multiple for Castrol. **Valuing the stock at 16x, we initiate coverage on CSTRL with a 2-Year Target Price of Rs.169, which implies 51% upside from the current level.**

Financial Summary Y/E Dec (Rs.mn)	CY18	CY19	CY20E	CY21E	CY22E
Revenue	39,046	38,768	27,702	38,273	42,460
PAT	7,084	8,274	6,153	9,300	10,440
EPS (Rs)	7.2	8.4	6.2	9.4	10.6
PE (x)	15.6	13.4	18.0	11.9	10.6

Source: Company, RSec Research

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Share price (%)	1 mth	3 mth	12 mth
Absolute performance	(5.9)	(4.4)	(14.2)
Relative to Nifty	(9.1)	(12.2)	(16.0)

Shareholding Pattern (%)	Mar-20	Jun-20
Promoter	51.0	51.0
Public	49.0	49.0

1 Year Stock Price Performance



Note: * CMP as on 20 October 2020

Our Thesis

CSTRL (EBITDA Rs 11.53bn - CY19)

Segment	Automotive	Industrial
Volume Break up -CY19(%)	90	10
Volume CAGR (CY16-CY19)	0.5%	2.8%
Volume CAGR (CY19-CY22E)	2.5%	2.5%

Key Sectoral Theme

- ▶ **Market Share – Castrol Dominates the Private Players:** The OMCs dominate the overall lubricant market with ~45% market share, while Castrol dominates the private players with ~12% market share. Castrol is the leading private player followed by Gulf Oil, Shell, Valvoline, Veedol and Total. As per the latest Industry data, Castrol’s market share in the retail segment increased to 18% in CY19 [\(Link\)](#) from 16% in CY17.
- ▶ **Domestic Auto Fuel Segment to Recovery with Long Term Growth:** Historically, India’s oil product sales volume clocked 5% CAGR over FY15-FY20 primarily driven by auto fuels. Further, the sales volume of diesel/ petrol clocked 4%/9% CAGR over the same period. Looking ahead, we expect the Indian auto fuel sales to grow by 5% per annum over next 3 years on the back of renewed confidence of Indian refiners (evident from their refinery capacity expansion), which augurs well for the lubricant industry.
- ▶ **Normalcy in Industrial Activity to Fuel Demand of Lubricants:** Industrial activity is steadily returning to normalcy with the continued easing of lockdown restrictions. Going forward, we believe that the manufacturing sector too will resume its growth trajectory along with the mining sector, which will fuel demand for CVs and in turn for lubricants. It is pertinent to note that industrial segment accounts for ~10% of CSTRL’s total sales volume.

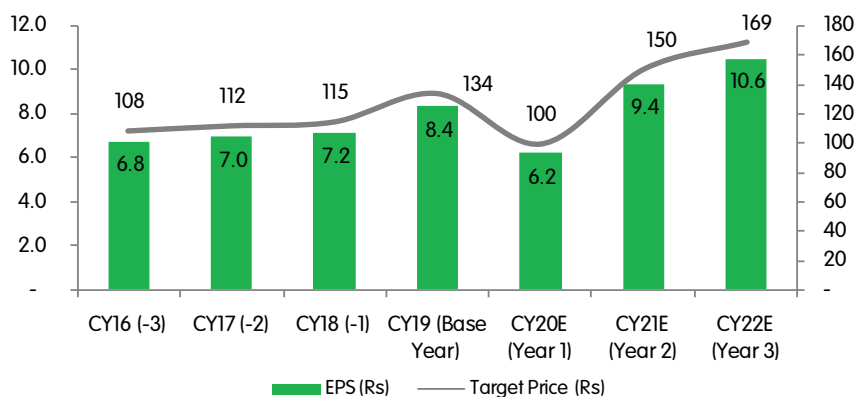
Key Investment Theme

- ▶ **RIL-BP JV offers Sustainable Volume Growth Opportunity:** Out of India’s total lubricant sales volume of 2.7bn litre, ~45% is consumed by the automobile industry, while retail fuel pumps enjoy ~20% market share. Based on this, we see annual lubricant sales of ~3,450 litres per retail fuel pump. RIL-BP tie-up suggests exclusive sales of Castrol’s lubricants at RIL’s 1,400 fuel pumps, which indicates sizeable volume growth of ~5mn litre (2% volume growth over CY19 base). The current network of 1,400 retail fuel pumps is expected to be increased to 5,500 in the next 3-4 years. RIL holds a license to open 5,000 fuel outlets and plans to double its market share in retail fuel segment from the current level of 3%. A tally of 5,500 fuel pumps with exclusive sales of Castrol lubricants will likely add ~19mn litre per annum of lubricants sales, which suggests ~9% volume growth over CY19.
- ▶ **Decade-low Oil Prices to Aid Gross Margin:** Strong (92%) correlation between crude oil prices and base oil prices since 1998 to CY20TD (in USD terms), suggests fall in crude prices leads to lower base oil prices. Moreover, the decline in crude price in 2019 also helped Castrol to improve its gross margin to 55% level. Based on the 1-year forward curve and estimates of Bloomberg, the Brent prices are seen at US\$42, US\$45 and US\$50 for CY20/21/22, respectively. In case, the crude prices remain at the least level of the current decade in CY20 and CY21, we expect Castrol to report an improved gross margin from 55% (CY19) to 58%, 59% and 59%, respectively in CY20, CY21 and CY22.
- ▶ **Outlook & Valuation:** Castrol traded at an average 1-yr forward PE of 23x over CY17-20TD. At CMP, the stock trades at 10.6x CY22 EPS of Rs10.6 and EV/EBITDA of 6.6x (CY22) with EBITDA CAGR of 6% (CY19-22). Current dividend yield is ~5%. Due to lubricant players’ similarity to FMCG companies in terms of financial metrics and consumer centric business, we have compared Castrol with FMCG peers and observed that it trades at 70% discount to FMCG players. The average RoE of FMCG proxy universe is ~50%, while PE multiple is 38x (consensus). Moreover, we have also calculated theoretical PE (dividend discount model), which is 15.6x for CY22E earnings. Hence, we are comfortable with our 16x target PE multiple for Castrol. **Valuing the stock at 16x, we initiate coverage on CSTRL with a 2-Year Target Price of Rs.169, which implies 51% upside from the current level.**

Key Risks

- ▶ Higher oil prices and rupee depreciation
- ▶ Delay in revival of automobile sector especially CV sales

EPS & Target Price



Source: Company, RSec Research

Price Sensitivity Analysis

	EPS (Rs)	Growth (%)	FWD P/E	14.0	16.0	18.0	20.0	22.0
CY16 (-3)	6.8		16.8	95	108	122	136	149
CY17 (-2)	7.0	3.2	16.3	98	112	126	140	154
CY18 (-1)	7.2	2.4	15.9	100	115	129	143	158
CY19 (Base Year)	8.4	16.8	13.6	117	134	151	167	184
CY20E (Year 1)	6.2	-25.6	18.3	87	100	112	124	137
CY21E (Year 2)	9.4	51.1	12.1	132	150	169	188	207
CY22E (Year 3)	10.6	12.3	10.8	148	169	190	211	232

Source: Company, RSec Research

Scenario Analysis – CY22E

Base Case Scenario: In Base Case scenario, we assumed volume and net realization of 220mn litre and Rs.193/litre, respectively for CY22E, which will result into EBITDA and EPS CAGR of 7% and 8%, respectively over CY19-CY22E. Assigning 16x P/E multiple to its CY22E EPS of Rs.10.6, we arrive at a Target Price of Rs.169.

Bull Case Scenario: In Bull Case scenario, we assumed volume and net realization of 226mn litre and Rs.201/litre, respectively for CY22E, which will result into EBITDA and EPS CAGR of 12% and 13%, respectively over CY19-CY22E. Assigning 18x P/E multiple to its CY22E EPS of Rs.12.1, we arrive at a Target Price of Rs.217.

Bear Case Scenario: In Bear Case scenario, we assumed volume/ net realization of 213mn litre and Rs.186/litre, respectively for CY22E, which will result into CSTR's EBITDA and EPS CAGR of 2% and 3%, respectively over CY19-CY22E. Assigning 14x P/E multiple to its CY22E EPS of Rs.9.1, we arrive at a Target Price of Rs.127.

Scenario Analysis

(Rs mn)	Base case CY22E	Bull Case CY22E	Bear Case CY22E
Volume (Mn lt)	220	226	213
Realisation (Rs/lt)	193	201	186
EBITDA	14,085	16,100	12,150
CAGR -CY19 -CY22E (%)	7.0	12.0	2.0
Net profit	10,440	11,936	9,003
EPS	10.6	12.1	9.1
CAGR -CY19 -CY22E (%)	8.0	13.0	3.0
ROCE (%)	52.6	54.0	43.7
ROE (%)	51.6	53.1	42.8
P/E multiple	16	18	14
Target Price (Rs)	169	217	127

Source: Company, RSec Research

Investment Decision Matrix (IDM)

Key Criteria	Score	Risk	Comments
Management Quality	7	Low	CSTRL has prudent management with a decent corporate governance track record; it is a part of British Petroleum (BP) Group, which has top-class management.
Promoter's Holding Pledge	6	Low	No pledging of shares by the promoter as of June 30, 2020.
Board of Directors Profile	7	Low	Out of 10 members, 3 are independent directors and 3 are nominee directors; independent directors include 1 director, who is on the boards of the companies like Pfizer, Kotak Mahindra Bank and Pidilite Industries; another independent director is on the board of the companies of repute i.e. GlaxoSmithKline Consumer Healthcare and HCL Infosystems, while the 3rd independent director is on the board of Axis Bank.
Industry Growth	6	Low	Global lubricants market size is projected to reach US\$182.6bn by 2025 from US\$157.6bn in 2020 (at 3% CAGR).
Regulatory Environment / Risk	4	High	The advent of electric vehicles and manufacturing of engines with higher drain interval are significant challenges; depreciating INR (since it imports base oil) and rise in crude oil prices to impact CSTRL's earnings; in terms of the regulatory environment, carbon emission is a worldwide piping issue and there is a rampant acceleration of green regulation; there is a steady rise in bio-degradable lubricants, which can further impact the demand for fossil lubricants.
Entry Barriers / Competition	3	High	There is a direct competition threat from the oil marketing companies (OMCs), which have better infrastructure in terms of retail outlet; it is a highly competitive business with limited scalability.
New Business/Client Potential	6	Low	In line with BS-VI requirements, the company came out with BS-VI ready lubricants across a range of categories; in partnership with 3M India, CSTRL is set to enter into US\$200mn vehicle care market; most of its clients are leading automotive OEMs; the passenger car ownership in India is expected to grow by 775% over the next two decades with 175 cars per 1,000 people in 2040, which will augment demand for lubricants.
Business Diversification	6	Low	The company offers a range of products and services across automotive, industrial and marine and energy segments; it is the market leader in retail automotive lubricant segment.
Market Share Potential	7	Low	RIL-BP tie-up suggests exclusive sales of Castrol's lubricants at RIL's 1,400 fuel pumps, which indicates sizeable volume growth of ~5mn litre (2% volume growth over CY19 base).
Margin Expansion Potential	6	Low	EBITDA margin is expected to expand to 33% by CY22E on the back of lower base oil pricing scenario, higher volume and cost optimization drive undertaken by the company; similarly, PAT margin is expected to witness 25% growth by CY22E.
Earning Growth	7	Low	EPS grew by ~12% over last 5 years; EPS is expected to grow by 8% until CY22E; earnings growth expected to be triggered by margin expansion rather than volume expansion.
Balance Sheet Strength	6	Low	Fixed asset turnover ratio indicates sluggishness in terms of output generated by its assets; negative working capital cycle further augments its ability to churn out resources efficiently; huge cash and cash equivalent suggests prudent liquidity management.
Debt Profile	7	Low	The company is debt-free with no long-term and short-term borrowing.
FCF Generation/NWC	6	Low	The company is expected to generate FCF to the tune of ~Rs 12.57bn till CY22E.
Dividend Policy	7	Low	Its dividend payout ratio over CY15-CY19 stands at ~71%; we expect this ratio to continue, going forward as well in the absence of any meaningful capex.
Total Score Out of 150	91		
Average Score (%)	61%	Low	

Environmental Social Governance Matrix (ESGM)

Key Criteria	Score	Risk	Comments
Environmental			
Climate Change and Carbon Emission	4	High	Lubricating oil, containing components obtained from crude oil, harms the environment and health. The company launched an industry-first Castrol Certified Carbon Neutral programme in India to help automotive dealerships reduce their carbon footprint. Castrol has collaborated with one of Bengaluru's leading automotive dealerships to become the first 'Castrol Certified Carbon Neutral' dealership by offsetting 100% of its operating emissions across all its 12 sales and service locations.
Air & Water Pollution	5	Medium	The manufacturing of lubricating oil is the most energy-intensive process, while the used lubricating oils are often burned in industrial or commercial boilers, which releases multiple pollutants including carbon dioxide to the atmosphere. However, the company has not received any show cause/legal notices from any State or Central Pollution Control Board. The company maintains a risk register with all the potential environmental, safety and health risk which is reviewed annually by the leadership team.
Biodiversity	3	High	Lubricating oil produced from crude oil is also a very significant threat to aquatic ecosystems; water containing 1ppm of oil is considered to be contaminated; oil spills that spread in the water and the coast do not allow oxygen, which causes complete disappearance of life in a given area. We did not find any major data points to comment on the company's effort in this segment.
Deforestation	3	High	Lubricating oils used in machines is emitted into the environment; therefore, the use of an oil base and refining additives of petroleum origin in the content of lubricants has some negative impacts on forestation and environment at large. We did not find any major data points to comment on the company's effort in this segment.
Energy Efficiency	6	Low	The company has upgraded the existing boiler (Rs4 lakh) by replacing oil pre-heaters, and installing efficient fuel pump, boiler nozzles, and flow meter etc; the benefit of reduction in furnace oil consumption is seen at Rs30 crore per annum; CSTRL has invested Rs42 lakh for use of renewable/alternate energy; it has set up a 50KVA solar power plant, which meets 5% of power consumption at its plants.
Waste Management	6	Low	In CY19, the company invested in organic waste composter to treat canteen waste. All the plant sites at Silvassa, Patalganga and Paharpur have developed a programme on waste management focusing on i.e. reduce, reuse and recycle. Also, continued usage of recycling treated water from effluent treatment plant for sanitation, resulting in reduction of fresh water consumption.
Defence / Arms / Ammunition Exposure	9	Low	No exposure towards defence/arms/ammunition space.
Social			
Customer Satisfaction	7	Low	The company has won several national and international awards for customer excellence; it also has a top position i.e. Vice President, (Customer Excellence), which clearly shows the importance of customer satisfaction for the management.
Data Protection & Privacy	6	Low	The company has a risk management committee in place, which actively monitors and reviews cybersecurity risks.
Gender & Diversity	5	Medium	The company has women engineers at Patalganga and Silvassa plants in the management category; several women occupied 18% managerial positions in 2019, while they constitute 19% at the company level.

Employee Engagement	6	Low	Part-time job, work from home, and flexible hours are some of the initiatives undertaken by the company to help its employees; career break and maternity/ paternity leaves are offered to the employees irrespective of their hierarchy.
Community Relations / Service	7	Low	The company spent Rs22.7 crore on (2.7% of CY19's PAT) various CSR activities i.e. livelihood enhancement, promotion of road safety, education including special education and employment enhancing vocation skills and disaster relief.
Human Rights	7	Low	CSTRL's most policies are aligned with that of BP group, which incorporate the global best practices.
Labour Standard	6	Low	The strength of the labour relations at the plants is also indicated by the absence of unionization of contractual labour; no loss of man-days was reported due to labour unrest/indiscipline; the company has completed the long-term settlement negotiations at Paharpur plant in 2019.

Governance

Audit Committee Structure	6	Low	As on CY19, CSTRL's audit committee was comprised of 5 members, out of whom 4 members were independent directors and 1 member was a nominee director (BP Group); the chairman of the committee is an independent director; only 1 member attended all 4 meetings held in CY19.
Bribery & Corruption	7	Low	Being a part of the BP group, strict compliance checks are in place at CSTRL; the company complies with all applicable laws/regulations that prohibit bribery and corruption; it also ensures that its suppliers, contractors and business partners adhere to the same; all business partners, who represent/act on behalf of the company are asked to comply with the applicable anti-bribery and anti-corruption laws.
Executive Compensation	6	Low	The average percentage increase made in salaries of employees (other than managerial personnel) was 10.1% in CY19, while the managerial remuneration was increased by 14%. Net profit increased by 18% YoY in CY19.
Lobbying	6	Low	As per the code of conduct, the company could engage in policy debates in various ways including lobbying on subjects of legitimate concern to the company, its staff and the communities in which it operates; however, this is being done in a highly regulated manner by authorized personnel only.
Political Contribution	8	Low	The company neither directly participates in any activity promoted by any political party nor it makes a political contribution in any form
Whistleblower Scheme	8	Low	CSTRL has a very strong whistleblower policy viz. 'Open Talk'; all employees also have access to the chairman of the audit committee in case they wish to report any concern; the company has a dedicated e-mail ID for reporting such concerns.
Total Score Out of 200	121		
Total Score (%)	61%	Low	

Score	For < 5	Red	High Risk	For 5	Blue	Medium Risk	For > 5	Green	Low Risk
Total Score (%)	For < 50	Red	High Risk	For 50	Blue	Medium Risk	For > 50	Green	Low Risk

Impact of COVID-19 on Industry & Company

- ▶ As per the Petroleum Planning & Analysis Cell (PPAC) data, India's lubricant consumption demand declined to 35%/33%/57% in Mar/Apr/May'20, respectively. However, only in Jun'20, lubricant sales touched the year-ago level albeit on lower YoY base. We believe the real recovery in lubricant sales volume reflected in July'20 (up 5.3% YoY), which continued in August'20 also. Earlier-than-expected recovery in lubricant sales could be backed by: (1) higher pent-up demand for vehicle repairing/servicing in 2HCY20; (2) improved automobile sales and higher diesel-petrol consumption, which touched 85-92% of the normal level, respectively.
- ▶ Whilst CSTR's sales volume declined by 37% YoY in 1HCY20, we expect sales volume to completely recover by 4QCY20. We also expect a positive surprise on sales volume front in 3QCY20 in light of the PPAC data, which suggest a complete recovery in finished lubricants.
- ▶ India is a net importer of base oil for manufacturing of finished lubricants. Base oil import slumped to 92%/36%/74% in Apr/May/Jun'20, respectively and recovered to 88% of the normal level in July'20.
- ▶ Consumption of lubricants in the rural markets has not been impacted significantly. As the maintenance of agricultural equipment is cyclical in nature, which usually peaks at around the harvest season, we expect improvement in rural volume during harvesting season.
- ▶ Demand for additized lubricants used in the power generation sector is expected to recover as the electricity demand recoups.
- ▶ July IIP data suggest a recovery in industrial activity, which will definitely lead to a rise in consumption of lubricants in the coming months.

Management Concall Takeaways

- ▶ **Management Commentary:** Castrol India added 500 retail outlets and 500 new customers in 1H CY20. It started several online training for mechanics and offers for their B2B customers. Cash delivery was the key priority, as ~85% of delivery was achieved compared to 1H CY19. The company supported its customers by extending credit tenure.
- ▶ **Buyback of Shares:** As the company has a significant amount of cash on the balancesheet, the buyback proposal shall be evaluated at a suitable time.
- ▶ **Partnership with BP-Jio:** Being the sole supplier for 1,400 retail units, which will further be expanded to 5,500 retail units, offers more brand visibility. Notably, it has started supplying to some of the retail units.
- ▶ **Future Mobility:** Just like a partnership with 3M India, the company is keen on looking at a similar opportunity in future.
- ▶ **Demand for Internal Combustion Engine Oil:** The management expects the demand for internal combustion engine oil to continue for the next 20-30 years. The advent of electric vehicles (EVs) and the resultant disruptions far away. Low vehicular penetration suggests long-term growth opportunities for the lubricant industry in general and CSTRL in particular.
- ▶ **Supply of EVs Fluids:** CSTRL supplies fluids to Tata for its EVs. But the management acknowledges it to be a very small part and expects meaningful growth momentum to come from internal combustion engine oil market only..
- ▶ **Sales-mix:** In terms of the sales mix, while automotive stands at 90%, non-automotive stands at 10%.
- ▶ **Ad-spend:** Following very low ad-spend in 2QCY20, the company started spending again from July'20 for the new products.
- ▶ **Volume within Automotive Segment:** While personal mobility accounts for 45%, the commercial mobility accounts for the rest. Demand pick-up has been good in two-wheelers space, which saw faster recovery compared to commercial vehicles and passenger vehicles. Good demand was seen in agriculture segment during May-Jun'20.
- ▶ **Decline in Realization:** Decline in the realization was more to do with the scheme floated by the company to speed up the collection cycle. As the company adopted such scheme (which ended in June'20) in the wake of liquidity issue, we expect realization to pick up in coming quarters.
- ▶ **Medium-to-long-term Growth:** The management continues to maintain its guidance of 5% CAGR over medium-to-long-term. However, it is quite apprehensive about the short-term growth prospects in light of the impact of COVID-19.
- ▶ **Variable Cost:** As per the management, the variable cost will go up with the increase in the volume. Further, recent decline in other expenses may not sustain, going forward.

Channel Check Takeaways

Lubricant Industry Survey

- ▶ Sales volume of lubricants or engine oil recovered up to ~ 60-65% of the normal level as of now. **(1) Western India:** overall sales volume recovered up to 60-70% of the normal level; **(2) Northern India:** overall sales volume recovered up to 55-60% of the normal level; **(3) Southern India:** consumption of industrial oil outpaced the consumption of automobile oil. Industrial sales volume of lubricants recovered up to 60-70% of the normal level, while automobile sales volume recovered up to 45% of the normal level.
- ▶ Castrol has offered discount up to ~Rs.600 on 15-litre bucket (mostly commercial vehicle engine oil).
- ▶ The dealers and distributors of engine oil in western India continue to face lesser supply of branded premium engine oils.
- ▶ Lockdown has badly affected the financial health of the people, which is forcing them to switch to local/cheaper engine oils in place of branded premium engine oils.
- ▶ Producers/suppliers of engine oil/lubricants have lowered the credit days to dealers/distributors in recent times possibly to improve realization.
- ▶ Most dealers expect a big boost in engine oil sales volume at the beginning of the festival season. Delayed recovery is mostly attributable to a reduction in credit cycle by the producers for which the dealers are not pushing sales with the lesser credit cycle. Dealers are mostly focusing on cash sales only.

Comparative Analysis

	Castrol India Ltd (CSTRL)	Gulf Oil Lubricants India Ltd (GOLIL)
Investment View		
Sales volume & Break up	<p>Sales volume stood at ~2,04,000 KL in CY19</p> <p>Break-up:</p> <p>45% ~ Passenger cars-2W } 45% ~ Commercial Vehicles } → 90% ~ Automotive 10% ~ Industrial & Commercial } 10% ~ Non-Automotive</p> <p>Realization stands at Rs 169/litre as of 30th June 20.</p>	<p>Sales volume stood at ~110,500 KL in FY20</p> <p>Break-up:</p> <p>60% ~ Automotive 40% ~ Non-Automotive</p> <p>Realization stood at Rs 143/litre as of 31st March 20.</p>
Utilisation	Capacity utilisation stood at ~80% in CY19	Capacity utilization stood at ~ 78% (as of 31st March 20).
Touch Points	Products are distributed through >350 distributors who service over one lakh customers and sub-distributors who reach out to additional outlets in semi-urban and rural markets. It has 3,000+ industrial clients.	A pan-India network comprising of >300 distributors and >50 industrial clients
Consumer details	Major customers include Tata Motors, Renault India, Honda Motorcycles	OEM tie-ups include Ashok Leyland, Volvo Penta, Mahindra & Mahindra, Swaraj and Bajaj Auto.
Growth Story	<ul style="list-style-type: none"> ▶ Aggressive towards passenger mobility ▶ More focus on retail outlets and bazar market ▶ Debt-free company gives leverage to expand ▶ Strategy of volume growth with no compromise on margins since last two decades.. 	<ul style="list-style-type: none"> ▶ Strong, net debt-free balance sheet with net worth of Rs.761 crore ▶ Rising market position in the domestic market ▶ Continuous efforts to develop new products. Number of new Products launched in FY20 - 30
Speciality	5-Years average RoCE stands at whopping 86% and 5-year RoE stands at 80%. This implies strong financial performance of the company, with tepid volume. .	5-Years average RoCE stands at 39% and 5-year RoE stands at 37%.

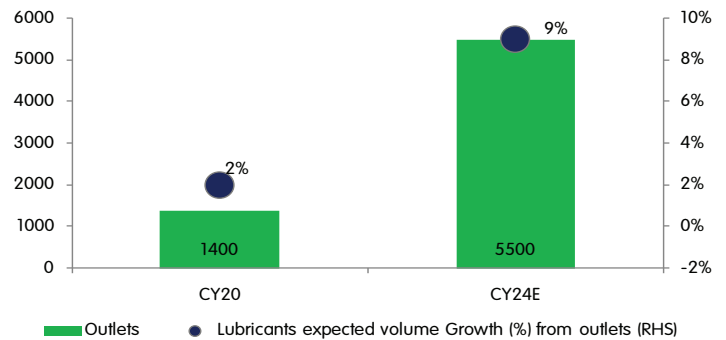
Financials (Rs Mn)	CY19	CY20E	CY21E	CY22E	FY20	FY21E	FY22E	FY23E
Net Revenues	38,768	27,702	38,273	42,460	16,435	14,125	16,510	17,857
EBITDA	11,530	8,453	12,616	14,085	2,865	2,243	2,900	3,107
PAT	8,274	6,153	9,300	10,440	2,025	1,581	2,076	2,344
Growth Financials (%)								
Net Revenues	-0.71	-28.55	38.16	10.94	3.65	-14.06	16.88	8.16
EBITDA	7.68	-26.69	49.25	11.65	1.23	-21.71	29.29	7.14
PAT	16.80	-25.63	51.14	12.26	13.90	-21.93	31.31	12.91
Margin (%)								
EBITDA Margin (%)	29.74	30.51	32.96	33.17	17.43	15.88	17.57	17.40
Net Margin (%)	21.34	22.21	24.30	24.59	12.32	11.19	12.57	13.13
Per share (Rs)								
EPS	8.36	6.22	9.40	10.56	40.34	31.49	41.35	46.69
Book Value	13.82	16.04	18.94	22.00	151.94	163.45	189.44	234.60
DPS	5.50	4.00	6.50	7.50	14.00	11.56	14.30	18.90
Valuation (X)								
P/E	13.4	18.0	11.9	10.6	15.74	20.16	15.36	13.60
EV/EBITDA	8.79	11.57	7.59	6.58	10.51	13.25	10.48	9.70
P/BV	8.1	7.0	5.9	5.1	4.18	3.88	3.35	2.71
Return Ratio (%)								
ROCE (%)	68.45	43.38	55.34	52.60	31.7	23.1	25.2	24.9
ROE (%)	65.34	41.67	53.75	51.56	30.0	19.9	23.3	23.1

Source: Company; RSec Research

Key Charts

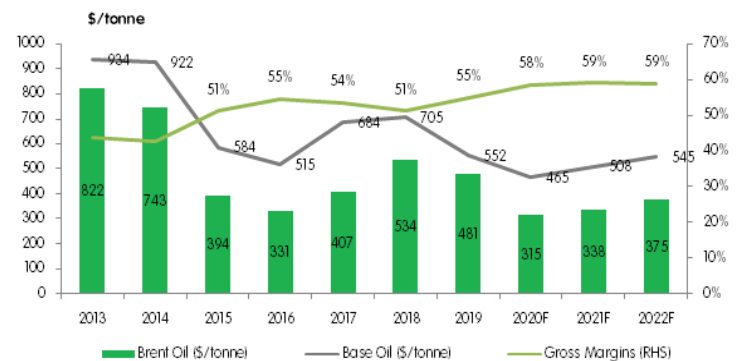
- ▶ A tally of 5,500 fuel pumps with exclusive sales of Castrol lubricants will likely add ~19mn litre per annum of lubricants sales, which suggests ~9% volume growth over CY19.

Exhibit 1: RIL-BP outlet number to cross 5,500 in next 4 years; Castrol lubricants exclusive sale growth from outlets 9% by CY24E



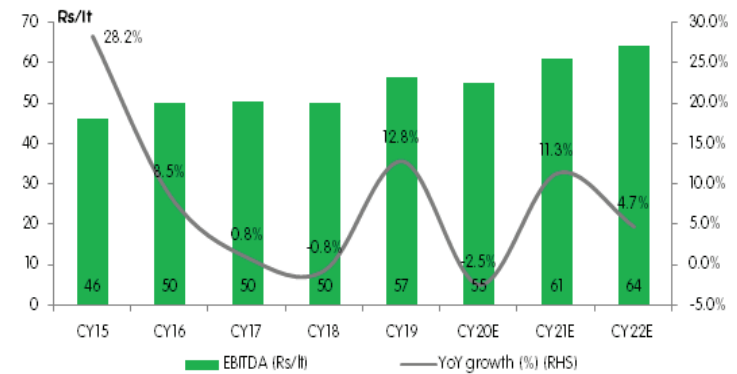
- ▶ Strong (92%) correlation between crude oil prices and base oil prices since 1998 to CY20TD (in USD terms), which shows fall in crude prices leads to lower base oil prices. We expect Castrol to report an improved gross margin of 58%, 59% and 59%, respectively in CY20, CY21 and CY22.

Exhibit: Lower crude price to lead lower base oil price and rise in gross margin



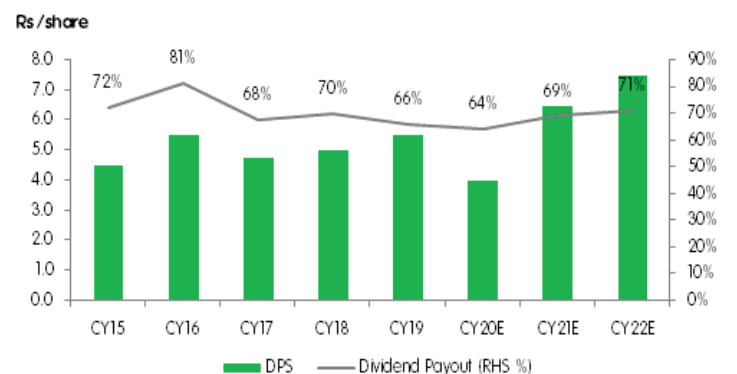
- ▶ Castrol is at the helm of brand recall. During the last 3 years, its realization clocked 4% CAGR. Looking ahead, we expect its blended realization to keep on increasing, which will continue to drive CSTRL's margin. Though we expect a blip in Castrol's realization in CY20, recovery is expected in CY21.

Exhibit 3: Premiumisation, lower base oil to improve EBITDA per unit realisation by CAGR of 4% over CY19-CY22



- ▶ The Company paid 66% total dividend in CY19. With the abolition of dividend distribution tax, we estimate dividend payout at 64-71% over CY20-22E.

Exhibit 4: Strong operating cash flow and company's policy to pay higher dividend to continue



Source: Company, RSec Research

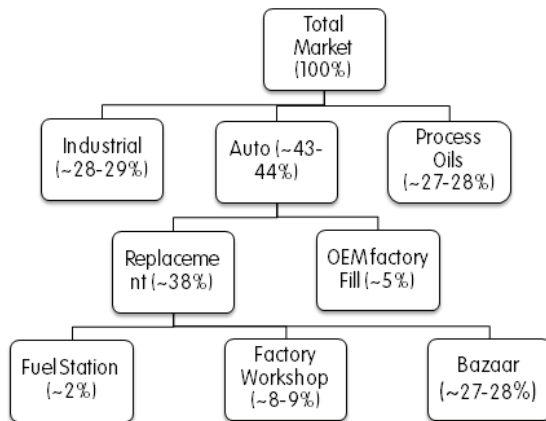
Industry Overview

India is the third largest market for finished lubricants in the world after the US and China. The total demand in India for finished lubricants, including process oils, is estimated at ~2.5MMT in 2019 with process oils accounting for one-third of the demand. The Indian lubricant market can be broadly classified into three segments: (1) automotive; (2) industrial; and (3) process/white oils and Castrol is present in automotive and industrial oil segment. Automotive lubricants dominate the market in India, with applications for Commercial Vehicles (CVs), Passenger Vehicles (PVs) and two-wheelers. Diesel Engine Oils (DEO) lead the automotive lubricant market, as they form ~45% of the market, followed by Motorcycle Oils (MCO) and Passenger Car Motor Oils (PCMO). The demand for automotive lubricants is directly related to the quantum of vehicle movement as well as the growth of the vehicle population. As improving vehicle engine technologies coupled with superior products has been leading to an increase in drain intervals, it is negative for the lubes industry. However, customers always prefer upgrading to branded products. Automotive segment, which has been growing at average 3% per year, is expected to grow at a similar rate in the foreseeable future.

Industrial Segment: The industrial lubricant segment comprises of hydraulic fluids, metalworking fluids, greases and industrial gear oil. These products are used in construction, manufacturing, textile, power generation, mining, food processing, light-heavy engineering, marine operations and metalworking sectors. Demand for industrial lubricant depends on the overall growth trends of the economy. The segment has been witnessing a muted 1-2% growth due to sluggish economic activities.

Infrastructure Segment: The infrastructure segment can be classified separately, as it leads the demand for both industrial and automotive lubricants since the products find application in both on-highway vehicles as well as off-highway construction equipment. Improving prospects of infrastructure sector, encouraging prospects of the rural economy, focus on energy efficiency, higher brand consciousness and continuous advancement of engine technology are some macro enablers that will contribute to the growth of India's

Exhibit 5: Overview of India's lubricant industry and market share details

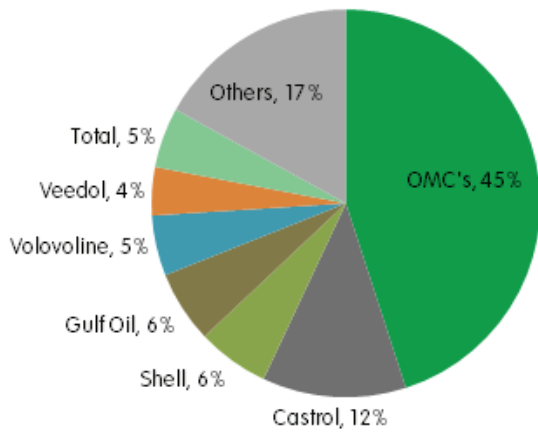


Source : Industry, Rsec Research

Market Share – Castrol Dominates the Private Players; OMCs Command a Lion’s Share

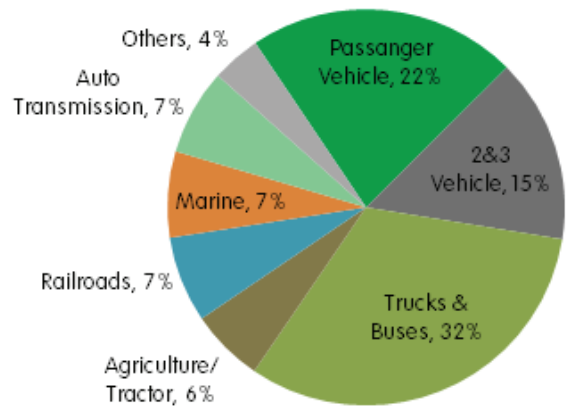
The OMCs dominate the overall lubricant market with ~45% market share, while Castrol dominates the private players with ~12% market share. In-house production of base oil at captive refineries offers a cost advantage to the OMCs over the private players. However, in the retail segment, they have a relatively weaker presence owing to the limited focus on marketing in the B2C segment. Again, as their lubes business is much smaller compared to refining/fuel marketing business, it draws limited capital and management bandwidth allocation. With ~12% market share, Castrol is the leading private player followed by Gulf Oil, Shell, Valvoline, Veedol and Total. As per the latest Nielsen data, Castrol’s market share in the retail segment increased to 18% in CY19 [\(Link\)](#) from 16% in CY17.

Exhibit 6: Player-wise market share break-up (%) in India



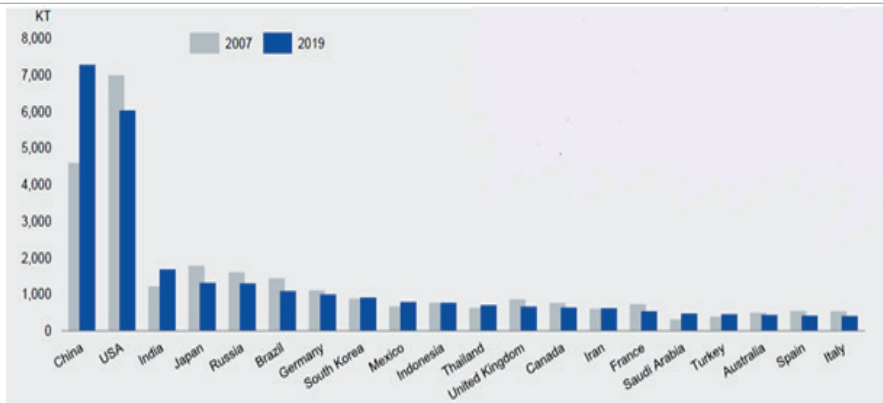
Source: Industry data, Rsec Research

Exhibit 7: Lube end use in transport segment



Source: Industry data, Rsec Research

Exhibit 8: Country-wise lubricant consumption

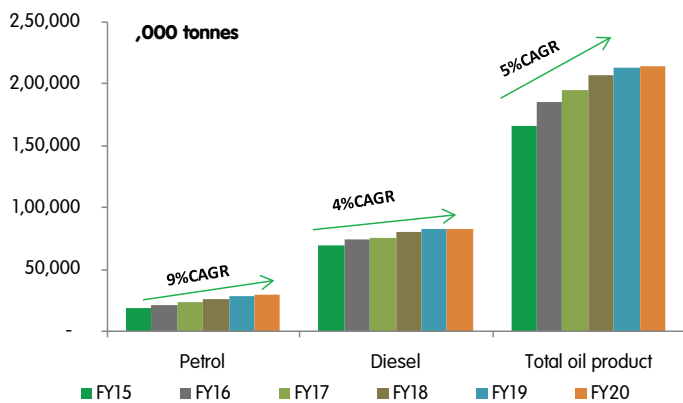


Source : Industry, Rsec Research

Domestic Auto Fuel Segment to Recover by 4QFY21

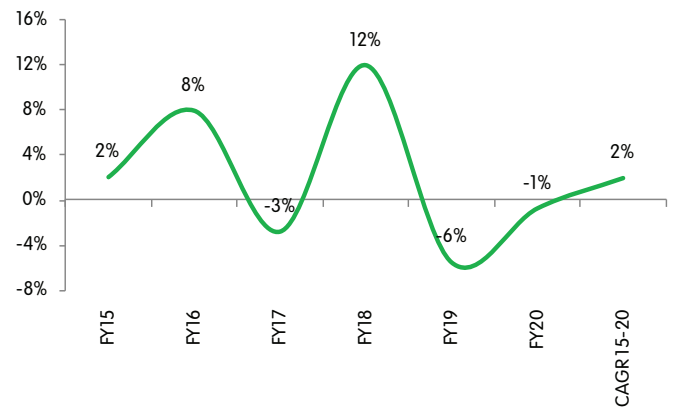
India, the world's third-biggest oil importer and consumer, has experienced a sharp decline in its fuel demand, mirroring a global trend following the COVID-19 outbreak. The country's oil product consumption declined by 21% YoY in Apr'20-Sept'20 period, while the consumption of gasoline/gasoiil, which is an indicator of automotive lubricant demand, slumped by 25%/28% YoY, respectively in FY21TD. A recent up-tick in automobiles sales, including tractors and the forthcoming festive season may lift fuel demand by the end of this year. Historically, India's oil product sales volume clocked 5% CAGR over FY15 to FY20 primarily driven by auto fuels. Further, the sales volume of diesel/petrol clocked 4%/9% CAGR over the same period. Looking ahead, we expect the Indian auto fuel sales to grow by 5% per annum over next 3 years on the back of renewed confidence of Indian refiners (evident from their refinery capacity expansion), which augurs well for the lubricant industry.

Exhibit 9: Growth of oil products, diesel and petrol consumption in India over last 5 years



Source: Industry data, Rsec Research

Exhibit 10: Lubricant and grease consumption in India (YoY growth)

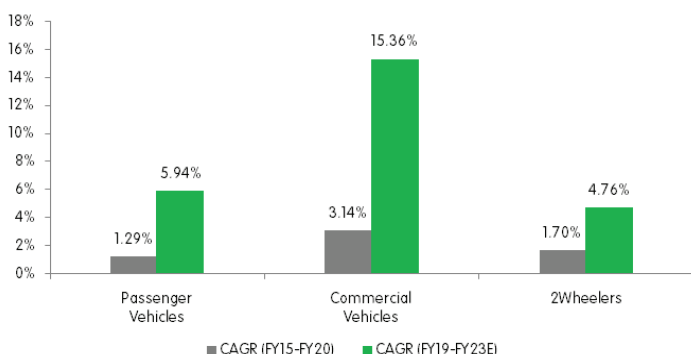


Source: Industry data, Rsec Research

Low Vehicular Penetration Suggests Long-term Growth Prospects for Lubricant Industry

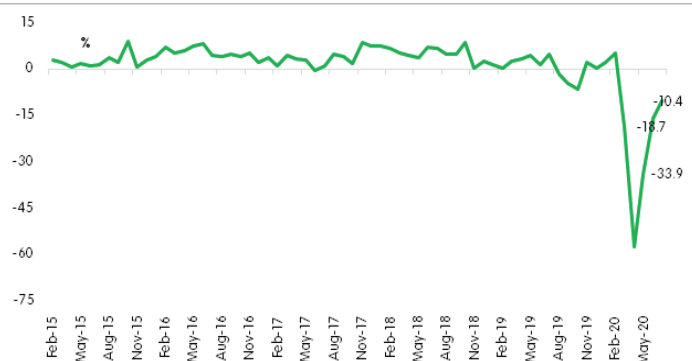
India's low 2-wheelers (2W) penetration stands at 12% compared to 25-30% level in some South-East Asian countries as well as few provinces. It implies further growth opportunities, particularly in the provinces where the penetration remains below 10%. Despite disappointing performance over the past decade, extremely low PV penetration of ~5% should drive long-term growth with the rise in the income level. While personnel mobility segment accounts for 45-50% of CSTR's total sales volume, 2W segment accounts for 30%. 2W sales volume, which clocked 1.7% volume CAGR over FY15-FY20, is expected to decline by 19.4% in FY21E and grow by 32% and 8% in FY22E and FY23E, respectively backed by social distancing norms and demand revival in rural markets. On the other hand, PV segment – which clocked 1.29% volume CAGR over FY15-FY20 – is expected to decline by 20.5% in FY21E and grow by 37.3% and 8.8% in FY22E and FY23E, respectively backed by strong demand revival in rural markets. CV segment, which clocked 3.14% volume CAGR over FY15-FY20, is expected to decline by 30.1% in FY21E and grow by 91.7% and 14.7% in FY22E and FY23E, respectively.

Exhibit 11: Overall growth in auto sector to improve lubricant consumption



Source: Industry data, Rsec Research

Exhibit 12: Steady recovery in India's IIP from the recent lows



Source: Bloomberg, Rsec Research

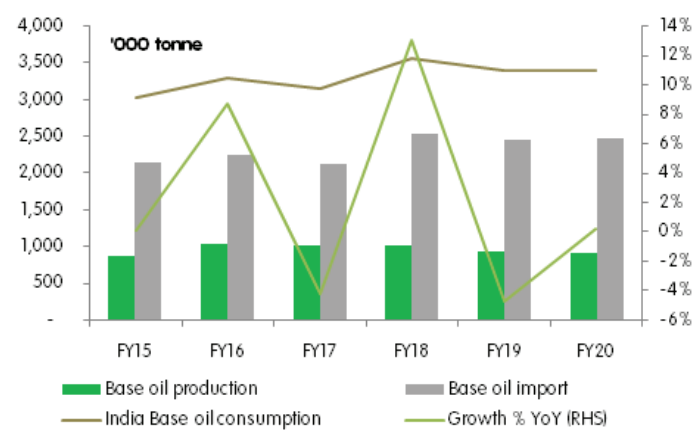
Normalcy in Industrial Activity to Fuel Demand of Lubricants

A steep decline in investment and private consumption-led to GDP recording its worst-ever contraction of 23.9% YoY in 1QFY21. However, the Index of Industrial Production (IIP) recovered further to contract by a lower-than-expected 10.4% YoY in July'20. Notably, industrial activity is steadily returning to normalcy with the continued easing of lockdown restrictions. Going forward, we believe that the manufacturing sector too will resume its growth trajectory along with the mining sector, which will fuel demand for CVs and in turn for lubricants. It is pertinent to note that industrial segment accounts for ~10% of CSTRL's total sales volume.

Base Oil Market Dynamics to Remain Unchanged for Castrol

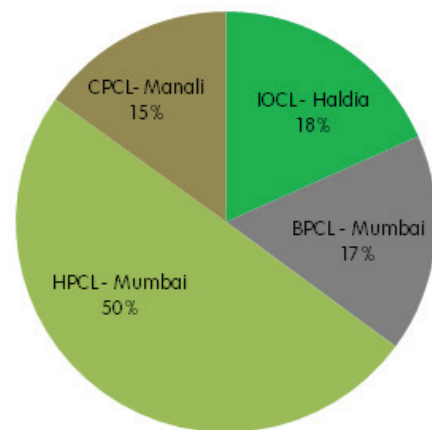
Against a total lubricant demand of ~2.5MMTPA, India's base oil (LOBS) production stands at ~1MMTPA. Thus, the country imports lubricant from the US, the Middle East and most recently from South Korea (Group-3 grade) to meet the demand. Domestically, HPCL Mumbai Refinery is the largest producer (0.47MMTPA) followed by IOCL's Haldia refinery (0.17MMTPA) and Manali refinery (0.14MMTPA) and BPCL's Mumbai refinery (0.16 MMTPA). Over the last 5 years, base oil production has remained unchanged in India, except for up-gradation to Group-2 and 3 types from Group-1. IOCL plans to spend Rs10bn to double base oil production at Haldia refinery in next 2 to 3 years. India's base oil consumption clocked 2.4% CAGR over FY15-FY20, while the country is net base oil-importing nation, with base oil imports clocking 3% CAGR over the last 5 years. Castrol is mostly dependent on imported base oil for manufacturing of finished lubricants. Despite the impact on macro scenario along with the crude price trend, base oil prices move with a lag of 3 months. Further, the exchange rate also plays an important role with INR appreciation bodes well for Castrol on the raw material front.

Exhibit 13: Consumption of base oil in India clocks 2.4% CAGR over FY15-FY20



Source: PPAC, Bloomberg, Rsec Research

Exhibit 14: Break-up of India's domestic base oil production (FY19)

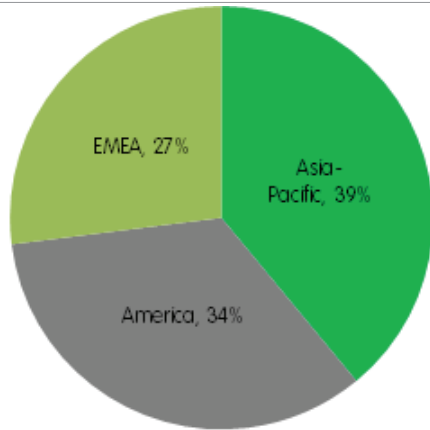


Source: Industry, Rsec Research

BRICS Nations to Boost Base Oil Growth

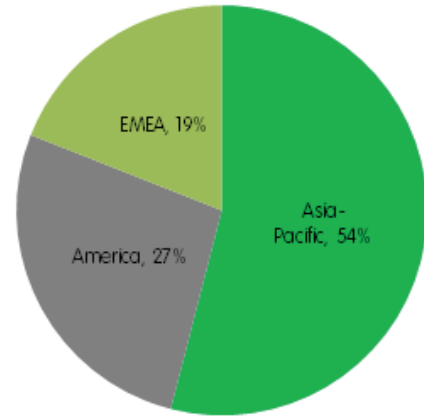
The base oil market size is projected to grow from US\$33.7bn in 2019 to US\$39.6bn by 2024, clocking 3.3% CAGR over 2019-2024. Surging demand for high-grade oils in the automotive industry and increasing GDP in the APAC region led by increasing industrial activities are fueling the market growth across the globe. Lucrative market opportunities and rising demand for renewable energy in the BRIC nations (Brazil, Russia, India, China and South Africa) are expected to fuel growth.

Exhibit 15: Region-wise break-up of global lubricant sales in 2000



Source: FUCHS, Industry Data, Rsec Research

Exhibit 16: Asia Pacific biggest consumer and growth engine for lubricants in 2019

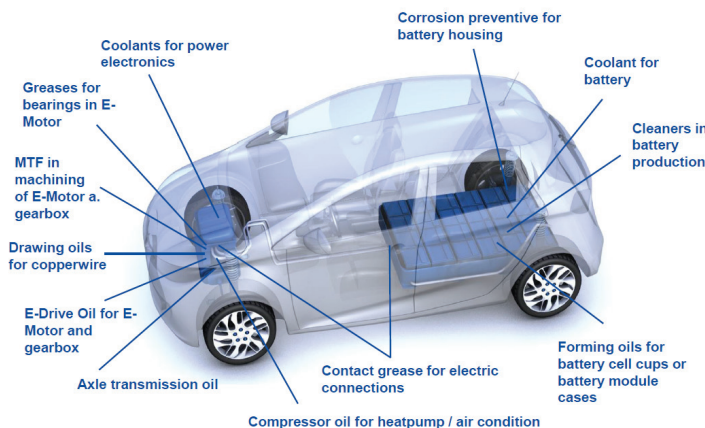


Source: FUCHS, Industry Data, Rsec Research

No Adverse Impact of EVs in the Near-term; Conventional Fuel to Stay Relevant in Medium-term

The management does not expect any impact from the EVs at least in the near-term. Given that the population of vehicles on road is rising by ~7-8% YoY (except for dip in FY19 & FY20) and the average life of CVs being 15 years and 7-8 years for other vehicles, a significant proportion of total vehicles will continue to use conventional fuel at least over the medium-term. The company expects passenger buses and three-wheelers to be impacted more than the CV segment. It expects 90mn new vehicle addition over next 5 years in India. As per BP's 2020 Energy Outlook report, global car fleet is expected to double from 1bn in 2018 to 1.9bn by 2035 and the number of EVs is likely to spurt from 1.2mn in 2015 (0.1% of global fleet) to ~100mn by 2035 (only 6% of global fleet). Around a quarter of these EVs will be Plug-In Hybrids (PHEVs), which run on both electric and oil, while three quarters are pure battery electric vehicles (BEVs). Electrification is an opportunity for Castrol to further strengthen its market leadership with technically advanced solutions. Electrification of cars will lead to new applications and higher requirements for existing applications. EVs will create whole new demand for gear oils, coolants, greases (e.g. contact with electrical currents and electromagnetic fields, higher heat emission, reduction gears with less gear steps and higher input speeds). The company supplies fluids to Tata's for EVs.

Exhibit 17: Lubricant applications in passenger cars



Source: Industry; Rsec Research

Exhibit 18: Electrification brings a plethora of opportunities

Powertrain Applications	ICE	HEV	BEV
Engine oil	✓	✓	-
Transmission oil	✓	✓	✓ / -
Greases	✓	✓	✓
Specialty greases	✓	+	+
Lubricants for Auxiliary systems	✓	+	+
Cooling & functional liquids	✓	+	+

- Omitted ✓ Required + Increased

Source: Industry; Rsec Research

Investment Rationale

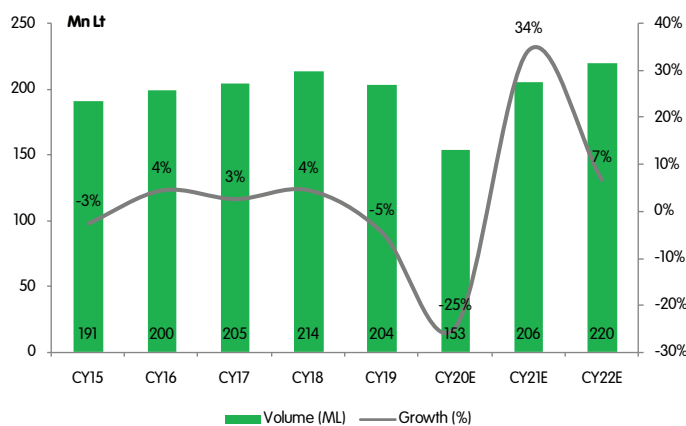
Our investment thesis is based on the following premises:

- I. Long-term Volume Growth Prospects Remain Intact
- II. Decade-low Oil Prices to Aid Gross Margin
- III. Premiumisation & Power Brands to Drive Realization & Margin
- IV. Foray into Car Care Market in Partnership with 3M India

I. Long-term Volume Growth Prospects Remain Intact

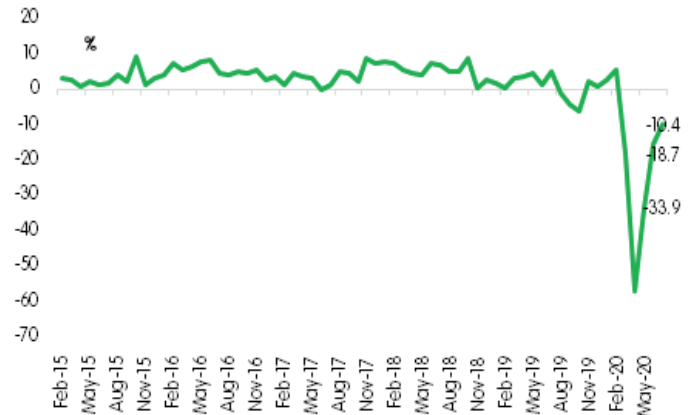
Castrol's total sales volume clocked just 2% CAGR over CY15-CY19 mainly due to 18% fall in automobile sales volume in FY20 and slowdown in India's industrial activity. Moreover, India's diesel demand declined by 1.1% in FY20 vs. 3.4% growth in FY19. In 1HCY20, Castrol's sales volume declined by a sharp 37% YoY, as the nationwide lockdown impacted demand for lubricants across automotive and industrial segments. Now, the government has started implementing unlocking in phases taking cognizance of the situation. As per the latest PPAC database, India's lubricant demand has recovered to normal level in July'20 and witnessed a further recovery in Aug'20 also. We expect a positive surprise on Castrol's sales volume front in 3QCY20 and marginal growth in 4QCY20. However, we project Castrol's lubricants volume to decline by ~29% in CY20 and witness sharp recovery in CY21. Despite the short-term impact of COVID-19, CSTRL has maintained long-term volume growth guidance of 5-6% per year. Over CY19-CY22E, we expect the company to deliver volume CAGR of 1% backed by: higher pent-up demand for vehicle repairing/servicing in 2HCY20, sustainable volume growth opportunity owing to RIL-BP JV, strategic alliances with auto majors, faster demand recovery in rural markets, digital technology and vast distribution network.

Exhibit 19: Castrol's volume is expected to clock 2.5% CAGR over CY19-CY22E



Source: Company, Rsec Research

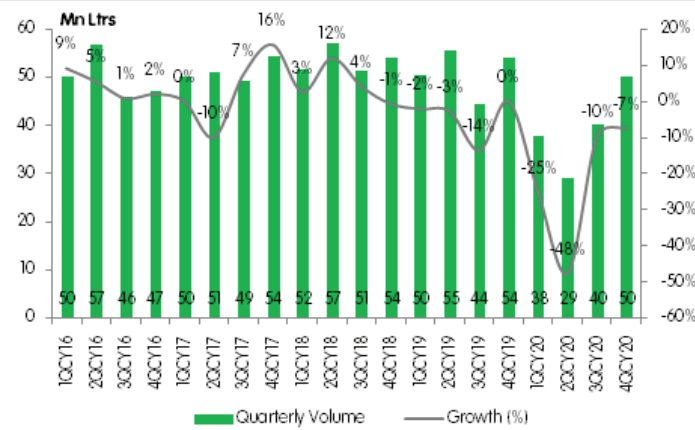
Exhibit 20: Steady recovery in India's IIP from the recent lows



Source: Bloomberg, Rsec Research

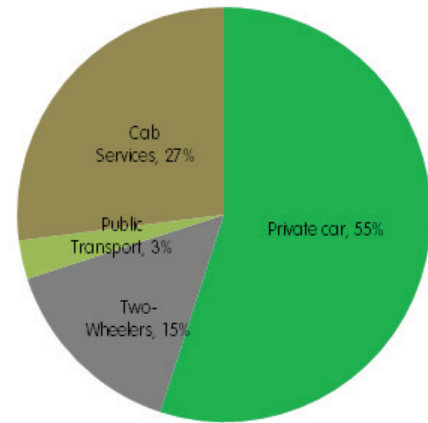
A. Higher Pent-up Demand for Vehicle Repairing/Servicing in 2HCY20: A large chunk of the country's entire vehicle fleet, which remained off-road for more than ~3/4 months, would require to be serviced to ensure brake lubrication and road testing, engine oil change, fuel system check and repairing. During the unlocking period, consumption of lubricants and grease has touched to the normal level. Based on an expert recommendation, every 2W should change oil at the ~2,000 km mark or once in 4-6 months and in the case of cars it is 7,500km or once in a year. As Castrol derives 90% of its sales volume from automobiles, this pent-up demand offers a huge opportunity for the company. We expect the company's sales volume to witness full recovery by 3QCY20 and witness marginal growth in 4QCY20. However, in light of muted performance over the previous quarters, Castrol's sales volume is expected to decline by 29% in CY20.

Exhibit 21: Pent up demand for vehicle repairing in fast lane in 2HCY20 to lead faster recovery in lubricants sales volume



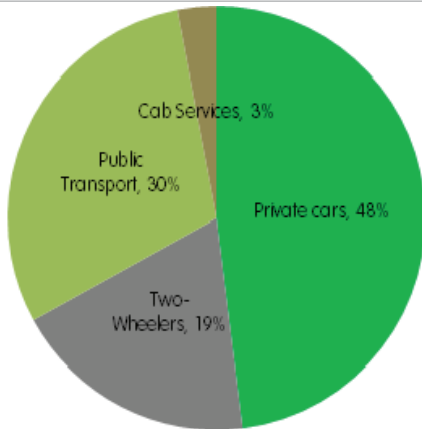
Source: Company; RSec Research

Exhibit 22: Shift from cabs to other modes of commute post lockdown, as per survey



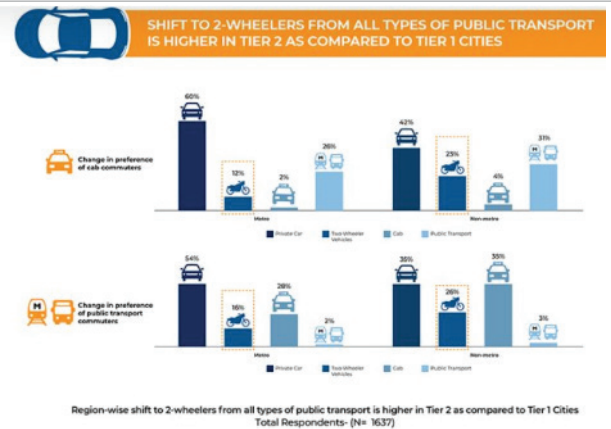
Source: Industry Survey, Rsec Research

Exhibit 23: Shift from public transport to other modes of commuting post lockdown, as per survey



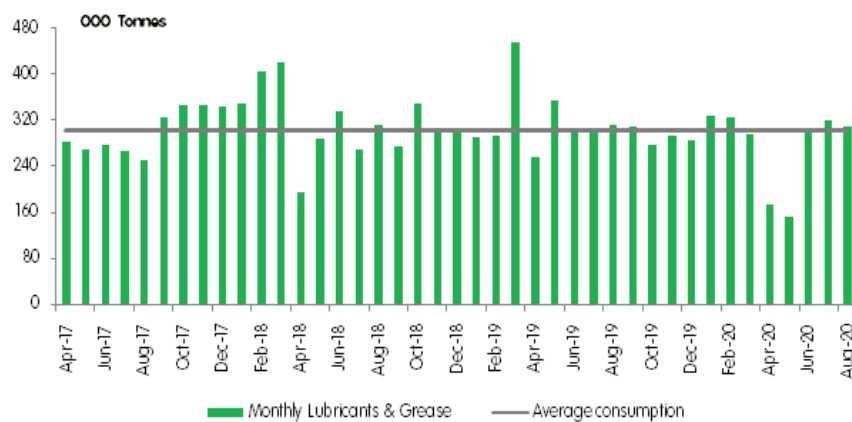
Source: Industry Survey, Rsec Research

Exhibit 24: Shift to two-wheeler from public transport is higher in Tier-II vs. Tier-I cities



Source: Industry Survey, Rsec Research

Exhibit 25: Recovery in monthly lubricants and grease volume consumption sustained in Aug'20

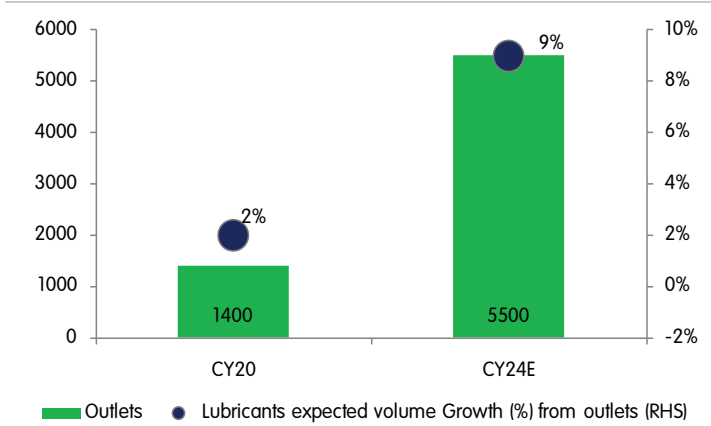


Source: PPAC, Rsec Research

B. RIL-BP JV offers Sustainable Volume Growth Opportunity: Global energy major BP and RIL formed their fuel retailing joint venture (JV) under the brand 'Jio-bp' in July'20. As part of the deal, BP has bought 49% stake in ~1,400 petrol pumps and 31 aviation turbine fuel (ATF) stations owned by RIL. The JV has begun selling fuels and exclusive Castrol lubricants with immediate effect from its existing retail outlets, which will be rebranded to 'Jio-bp' in due course. It will leverage RIL's presence across 21 states and its millions of consumers through 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.

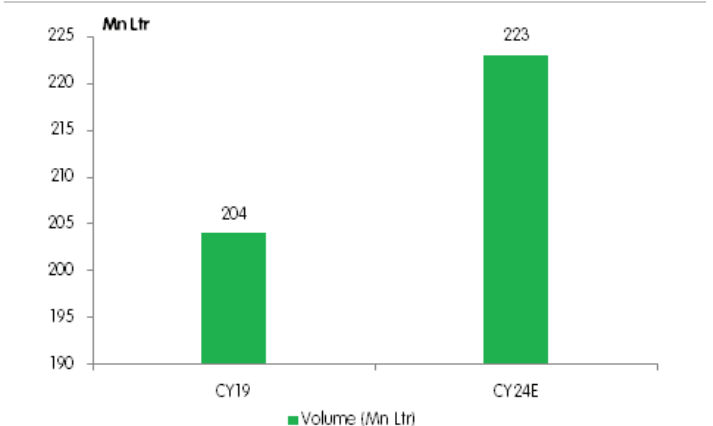
Out of India's total lubricant sales volume of 2.7bn litre, ~45% is consumed by the automobile industry, while retail fuel pumps enjoy ~20% market share. Based on this, we see annual lubricant sales of ~3,450 litres per retail fuel pump. RIL-BP tie-up suggests exclusive sales of Castrol's lubricants at RIL's 1,400 fuel pumps, which indicates sizeable volume growth of ~5mn litre (2% volume growth over CY19 base). The current network of 1,400 retail fuel pumps is expected to be increased to 5,500 in the next 3-4 years. RIL holds license to open 5,000 fuel outlets and plans to double its market share in retail fuel segment from the current level of 3%. A tally of 5,500 fuel pumps with exclusive sales of Castrol lubricants will likely add ~19mn litre per annum of lubricants sales, which suggests ~9% volume growth over CY19.

Exhibit 26: RIL- BP outlet number to cross 5,500 in next 4 years; Castrol lubricants exclusive sale growth from outlets 9% by CY24E



Source: Company, Rsec Research

Exhibit 27: RIL-BP partnership can boost lubricant sales volume by 9% post expansion



Source: Company, Rsec Research

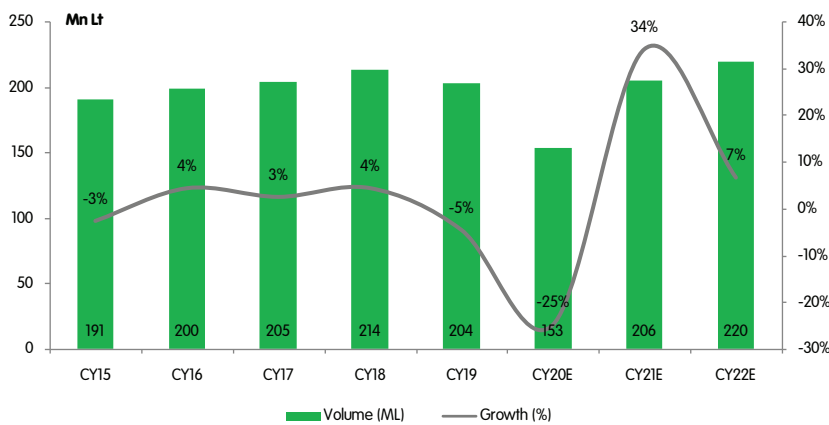
C. Strategic Alliances with Auto Majors to Drive Volume: Castrol India has been engaging with the OMCs and auto manufacturers to sell and develop its products over the periods. In the last 2 years, it has entered into strategic partnerships with Ford India, Honda two-wheelers, Jawa Motorcycles and Renault India. 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. It partnered with Renault in December 2019 for supply of exclusive after-sales engine oil lubricants with effect from January 2020. Tie-up with an auto major is not only a volume booster for Castrol, but also improves its premiumization/sales realization. Looking ahead, we expect Castrol's volume to clock 1% CAGR over CY19-CY22E.

Exhibit 28: Castrol's partnership with auto majors in last two years

Date	Partner	Objectives
5-Aug-19	Honda Motorcycle & Scooter India	New range of engine oils for their two wheelers
18-Dec-19	Renault India	To supply lubricants
11-Nov-18	Mahindra & Mahindra	To include aftermarket engine oils and transmission fluids for mahindra tractors
1-Nov-19	Ford India	To jointly develop products to enhance performance efficiently

Source: Company, Rsec Research

Exhibit 29: Castrol's expected volume CAGR over CY19-CY22E



Source : Company, Rsec Research

D. Automobile at Inflection Point – A Booster to Castrol Lubricants: As ~65% of the passengers use public transport currently, we see huge scope for a shift from mass mobility to owned mobility as the COVID-19 pandemic warrants social distancing. This proportion is much higher at 75-80% in large cities i.e. Mumbai/Kolkata. Shifting to personal mobility from mass mobility due to COVID-led compulsion would be a paradigm shift in the automobile sector, which will resultantly lead to higher demand for lubricants/grease from the OEMs as well as retail users.

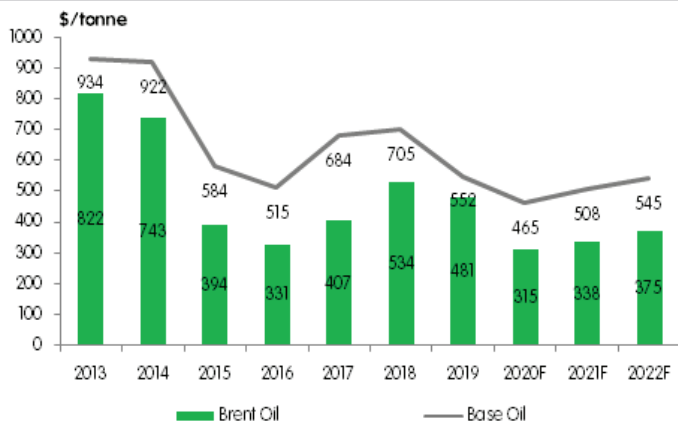
E. Lubricant Demand – Rural Markets to Witness Faster Recovery: Agriculture was the only major sector that registered positive growth (3.4% YoY) in 1QFY21. Agriculture commands a lion's share of ~45% in the rural economy. As per the rating agencies, agriculture GDP is expected to grow by 2.5% in FY21 backed by the normal and well-distributed monsoon, healthy sowing and better groundwater situation. As per the government data, 100% of normal Kharif area was sown as of August 2020 and sowing was ~7.2% higher on YoY comparison. The government's rural-focused policy (MGNREGS) and extension of concession credit to farmers through Kisan Credit Cards and front-loading of payment PMKSN (Pradhan Mantri Kisan Sanman Nidhi) augur well for the agriculture sector. Notably, in a recent conference call, Castrol's management highlighted earlier-than-expected recovery in sales volume of lubricants in rural markets.

F. Digital Technology & Vast Distribution Network: Leveraging digital technology i.e. "Castrol Fast Scan", the company's unique digital incentive platform for mechanics and retailers, crossed 1.75 lakh users in December 2019. At the beginning of 2020, the company also launched Castrol Fast Lane, a customer portal for retailers to explore the product range, place orders and view trade offers. The company has also started selling its products online via major e-commerce portals. Its products are distributed through >350 distributors, who service >1 lakh customers and sub-distributors across the country. Castrol is a market leader in Bazaar trade with ~21% market share where it has grown in the last 5 years. Bazaar trade is defined as direct retail sales in the replacement market and excludes fuel pump sales, which are dominated by the government-owned OMCs. Currently, 80% of CSTRL's automotive lubricants sales comes from the replacement market, while only 20% comes from fuel pumps/non-bazaar sales. The company also directly serves ~3,000 key institutional accounts.

II. Decade-low Oil Prices to Aid Gross Margin

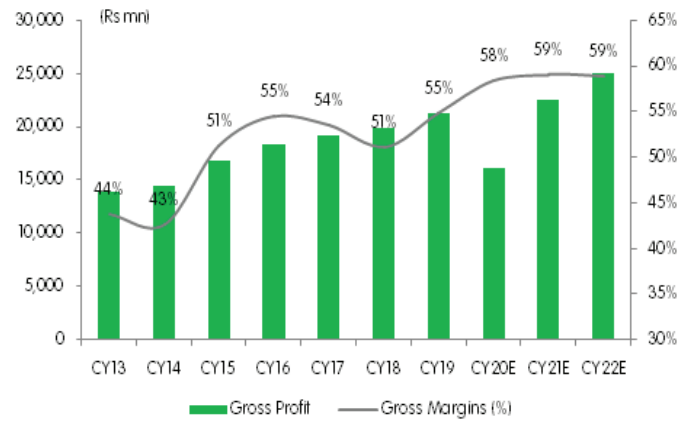
Notably, the average crude oil price of CY20 (CY20TD = US\$41/bbl lower than 2016=US\$44/bbl) is most likely to be the lowest of the decade. Consensus crude price of US\$45/50/bbl for CY21/CY22 suggests that the oil prices would remain subdued, which further suggests that the average oil price of CY21 could be the least at the beginning of the next decade. There is a strong (92%) correlation between crude oil prices and base oil prices since 1998 to CY20TD (in USD terms), which shows fall in crude prices leads to lower base oil prices. Notably, the crude prices corrected by 9% YoY, 47% and 16% YoY in 2014, 2015 and 2016, respectively. In line with crude prices, base oil price also corrected by 2% YoY, 38% YoY and 12%, while Castrol's gross margin improved to 52%, 55% and 54% from the level of 43% in 2014 during the same period. Moreover, the decline in crude price in 2019 also helped Castrol to improve its gross margin to 55% level. Based on the 1-year forward curve and estimates of Bloomberg, the Brent prices are seen at US\$42, US\$45 and US\$50 for CY20, CY21 and CY22, respectively. In case the crude prices remain at the least level of the current decade in CY20 and CY21, we expect Castrol to report an improved gross margin of 58%, 59% and 59% in CY20, CY21 and CY22, respectively.

Exhibit 30: Lower crude price to lead lower base oil price



Source: Industry, Rsec Research

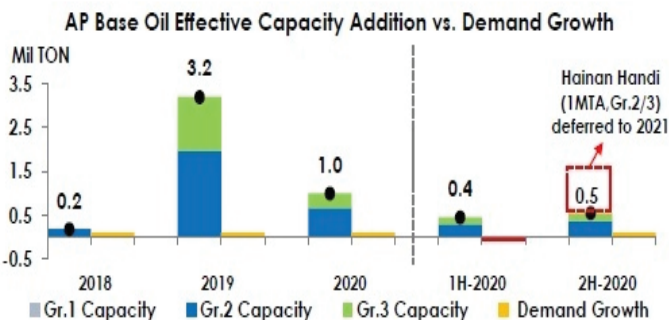
Exhibit 31: Soft base oil price to take Castrol's gross margin to new high of 59%



Source: Company, Rsec Research

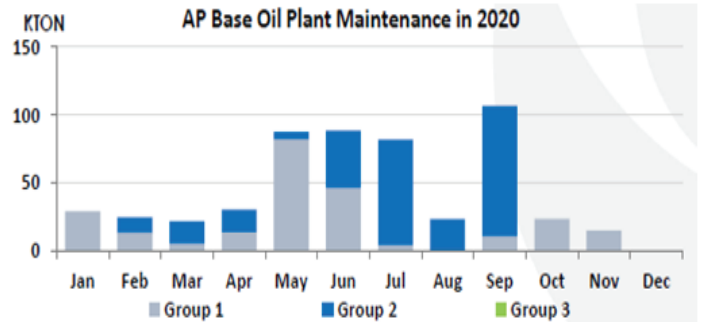
Steady Capacity Addition & Lower Maintenance Schedule in 2HCY20: Asia Pacific region added oil production capacity to the tune of ~3.2mn tonne (including Grade-II & Grade-III) in CY19, and the region is expected to add additional capacity of 1mn tonne in 2020 (Exhibit no. 32) in CY20 vs. demand expectation of ~0.1mn tonne. Along with this, the base oil plant maintenance level is seen at the lowest level in 2HCY20 of CY20 (Exhibit no. 33). It will likely to lead to soft base oil prices.

Exhibit 32: APAC base oil capacity addition at higher rate vs. demand growth



Source: Industry, Rsec Research

Exhibit 33: Lower base oil production plant maintenance in 2HCY20 suggest softer prices

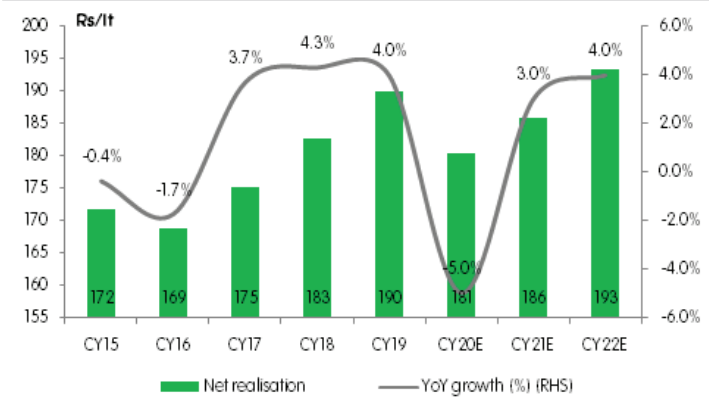


Source: Industry, Rsec Research

III. Premiumisation & Power Brands to Drive Realization & Margin

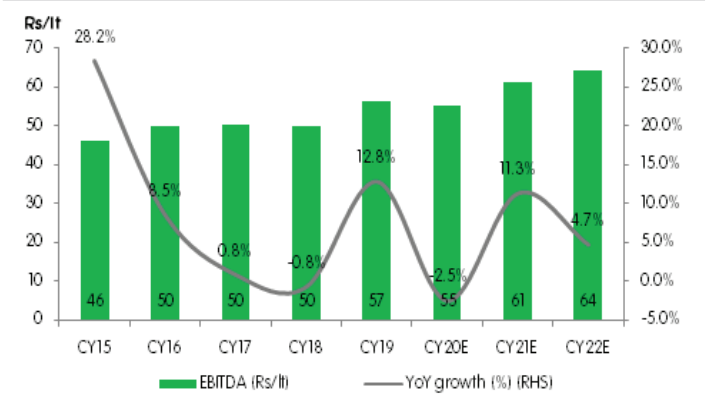
The lube industry is characterized by brand building, innovation and premiumization, which aid market share gain and pricing power. New products are launched based on largely homogenous specifications (like viscosity), though branding helps to boost customer preference. However, the CV customers are value chasers seeking better economics (long drain, pricing and distribution reach etc). Castrol is at the helm of brand recall. During the last 3 years, its realization clocked 4% CAGR. Looking ahead, we expect its blended realization to keep on increasing, which will continue to drive CSTRL's margin. Though we expect a blip in Castrol's realization in CY20, recovery is expected in CY21.

Exhibit 34: Premiumisation to drive net realisation to new peak in CY22



Source: Company, Rsec Research

Exhibit 35: Premiumisation, lower base oil to improve EBITDA per realisation by 4% CAGR over CY19-CY22



Source: Company, Rsec Research

IV. Foray into Car Care Market in Partnership with 3M India

Increase in per capita income in the developing economies like India is expected to drive the car care products market. From the past few years, demand for car care products is increasing due to an increase in sales of premium cars. In countries like India, there are older cars (>7-8 years), which might further propel the growth of the market in the region. As per the estimates of Castrol & 3M, India's car care market size is of US\$200-300mn, which grows at 10% annually.

Moving beyond lubricants, the company is exploring different business models through adjacent businesses. It entered into a strategic collaboration with 3M India to introduce a range of quality vehicle care products in automotive after-market. In a strategic collaboration with 3M India, Castrol launched co-branded vehicle care range for cars and bikes through its strong network of independent workshops and retail outlets in India. 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. Castrol and 3M India look forward to harness a new business model with this collaboration. While Castrol offers 3M's vehicle-care products range to its customers and consumers and 3M India will leverage the strength of Castrol's pan-India marketing and distribution network of >100,000 independent workshops and retail outlets.

Outlook & Valuation

Castrol will continue to focus and invest in personal mobility (while doing so, the company has delivered earning CAGR of 12% over the last 5 year), as passenger car motor oil (PCMO) is more profitable than B2B segments. The recent deal with 3M India is a reflection of the company's diversification into new avenues. The company expects lubrication industry to grow by ~5-6% over next 3 years (barring CY20 due to COVID-19 effect) and we believe Castrol to deliver volume CAGR of 2.5% over CY9-CY22E backed by: (1) RIL-BP JV offers long-term volume growth opportunity of 2-9% for its lubricants; (2) higher pent-up demand for vehicle repairing/servicing in 2HCY20; (3) strategic partnership with auto majors to aid incremental volume growth; (4) digital technology and vast distribution network; and (5) faster demand recovery for lubricants in rural markets. In light of these, we estimate CSTR's CY20/CY21/CY22 volume at 153mn/206m/220mn liters (-25%/+34% /+7% YoY), with realization at Rs180/Rs186per liter (-5%/+3% YoY) in CY20/CY21.

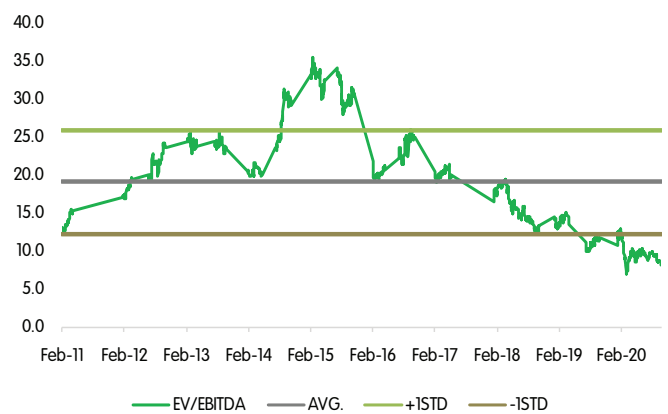
Castrol traded at an average 1-yr forward PE of 23x over CY17-20TD. At CMP, the stock trades at 10.6x CY22 EPS of Rs10.6 and EV/EBITDA of 6.6x (CY22) with EBITDA CAGR of 6% (CY19-22). Current dividend yield is ~5%. Due to lubricant players' similarity to FMCG companies in terms of financial metrics and consumer centric business, we have compared Castrol with FMCG peers and observed that it trades at 70% discount to FMCG players. The average RoE of FMCG proxy universe is ~50%, while PE multiple is 38x (consensus). Moreover, we have also calculated theoretical PE (dividend discount model), which is 15.6x for CY22E earnings. Hence, we are comfortable with our 16x target PE multiple for Castrol. **Valuing the stock at 16x, we initiate coverage on CSTR with a 2-Year Target Price of Rs.169, which implies 51% upside from the current level.**

Exhibit 36: Castrol 1 yr Forward P/E Valuation



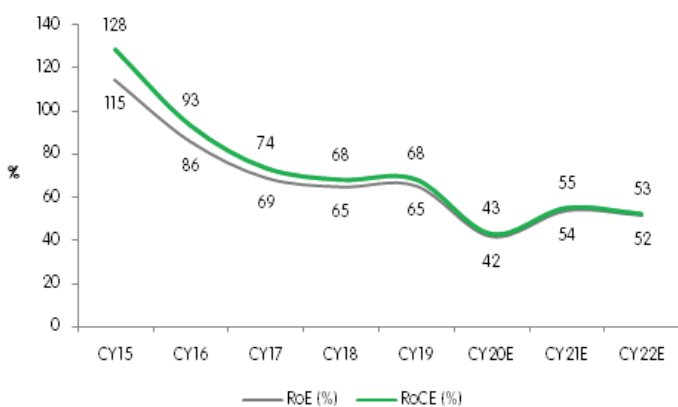
Source: Bloomberg, Rsec Research

Exhibit 37: Castrol 1 yr Forward EV/EBITDA Valuation



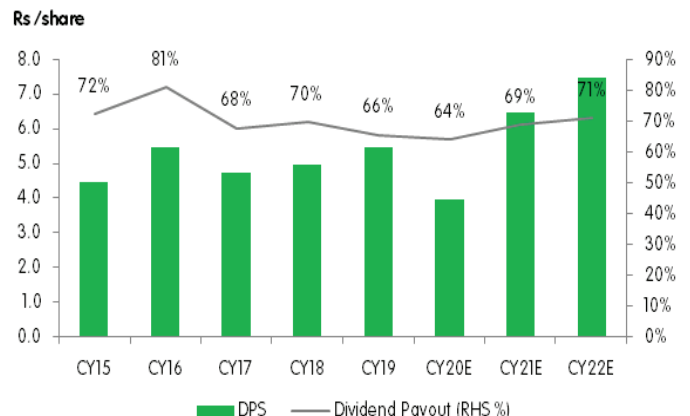
Source: Company, Rsec Research

Exhibit 38: Stable return ratio of Castrol



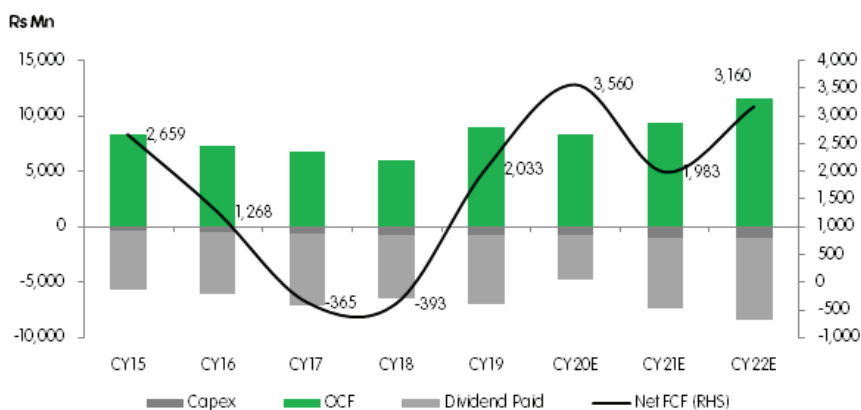
Source: Company, Rsec Research

Exhibit 39: Strong OCF and higher dividend payout to continue



Source: Company, Rsec Research

Exhibit 40: Castrol to post positive FCF despite high dividend payout and capex



Source : Company, RSec Research

As Castrol is net cash company (Rs11bn in 1HCY20), events like special dividends, bonus shares and buybacks cannot be ruled out in future.

High Dividend Payout Track Record: Castrol has incurred capex of Rs0.75bn in CY19 and has earmarked ~Rs1 bn/year for next 3 years. The company paid 66% total dividend in CY19. With the abolition of dividend distribution tax, we estimate dividend payout at 64-71% over CY20-22E, as we expect the Board to keep dividend payout high owing to limited investment opportunities. However, we still expect net cash balances to increase from Rs13bn as of CY20 to Rs18bn by CY22E.

Prudent Balance Sheet Management: Given the poor economic environment in 2QCY20, the management focuses on cash recovery. The discount scheme led to volume off-take and recovery from the debtors. As a result, working capital dropped sharply (especially compared to earlier quarters), while operating cash flow in 1CY20 stood at 85% of the year-ago level. Cash balance stood at a record level of Rs11.07bn as of Jun'20-end. Even adjusting for the dividend payout of Rs1.5bn, its cash (including the liabilities) stood at Rs9.6bn as of now, which is marginally higher than Rs9.5bn as of CY19-end.

Working Capital Cycle: Despite low volume growth, negative working capital played a crucial role in safeguarding its margin. This is evident from the increase in EBITDA margin and PAT margin to 30% (from 27% in CY15) and 21% (from 19% in CY15) in CY19, respectively. High creditor's days can be attributed to its long-term relationship with its suppliers. Average inventory days have been ~78 days (CY15-CY19) mainly due to its focus on building an institutional business (B2B vertical). Debtor's days have increased due to increased credit facility extended to its customers. Notably, the company has been able to manage negative working capital due to its leadership position and goodwill. Going forward, we believe the cash conversion ratio to fluctuate in the range of 5-15 days.

Exhibit 41: Cash Conversion Cycle

(Year-end basis)	CY15	CY16	CY17	CY18	CY19	CY20E	CY21E	CY22E
Inventory Days	79	91	70	85	67	77	73	73
Debtors Days	26	28	29	37	45	42	40	35
Creditor Days	144	137	150	121	116	125	125	122
Cash Conversion Cycle	(39)	(18)	(51)	(0)	(4)	(6)	(12)	(14)

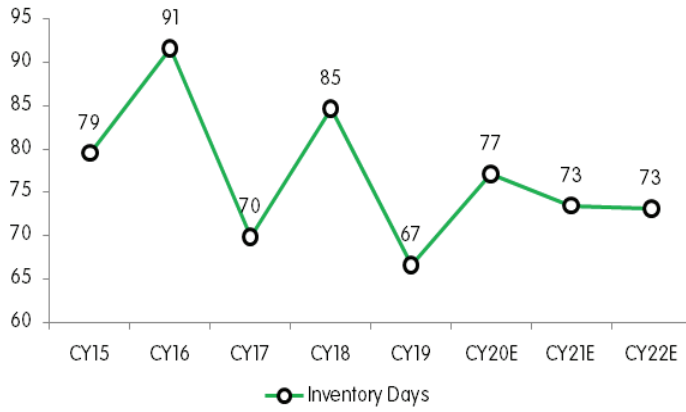
Source: Company Rsec Research

Theoretical PE (x) Calculation

ROE	49.0%
Long term growth	3.0%
Cost of Equity	9.0%
Theoretical PE (x)	15.6

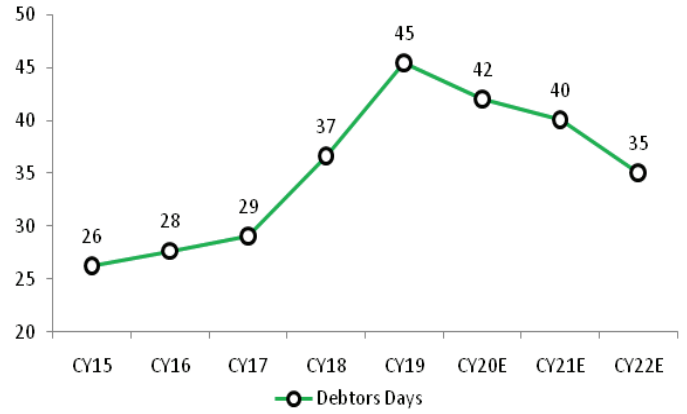
Source : Company, RSec Research

Exhibit 42: Inventory days to remain ~73 compared to ~80 historically



Source: Company, Rsec Research

Exhibit 43: Debtors days to improve from 45 days in CY19 to 35 days in CY22E



Source: Company, Rsec Research

Profit & Loss Statement

Y/E Dec (Rs mn)	CY18	CY19	CY20E	CY21E	CY22E
Revenue	39,046	38,768	27,702	38,273	42,460
Growth (%)	9%	-1%	-29%	38%	11%
Cost of materials	-17,578	-14,883	-9,464	-13,414	-15,047
Employee cost	-2,034	-2,131	-2,024	-2,186	-2,361
Other expenses	-8,726	-10,224	-7,760	-10,058	-10,966
EBITDA	10,708	11,530	8,453	12,616	14,085
EBITDA Margins	27%	30%	31%	33%	33%
Growth (%)	4%	8%	-27%	49%	12%
DDA	-556	-697	-780	-888	-1,008
EBIT	10,152	10,833	7,673	11,728	13,077
Other Income	843	648	626	810	996
Finance cost	-11	-12	-12	-12	-12
PBT	10,984	11,469	8,287	12,525	14,061
Tax	-3,901	-3,195	-2,134	-3,225	-3,621
PAT	7,084	8,274	6,153	9,300	10,440
Net Profit Margins (%)	18%	21%	22%	24%	25%
Growth (%)	2%	17%	-26%	51%	12%
No of equity shares (Mn)	989	989	989	989	989
EPS	7.2	8.4	6.2	9.4	10.6
Dividend Per share	5.0	5.5	4.0	6.5	7.5

Balance Sheet Statement

Y/E Dec (Rs mn)	CY18	CY19	CY20E	CY21E	CY22E
Shareholder's funds	11,657	13,670	15,867	18,737	21,759
Share capital	4,946	4,946	4,946	4,946	4,946
Reserves & Surplus	6,711	8,724	10,921	13,792	16,814
Current Liabilities	9,411	8,618	7,142	8,494	8,930
Trade Payable	5,841	4,718	3,241	4,594	5,029
Other Current Liabilities	3,003	3,229	3,229	3,229	3,229
ST Provisions	567	671	671	671	671
Total Liabilities	21,068	22,288	23,008	27,231	30,689
Non-Current Asset	2,744	2,855	2,813	2,831	2,717
Net Fixed Assets	1,860	1,997	2,017	2,129	2,121
Capital Work-in-progress	350	273	273	273	273
Deferred Tax Assets (Net)	533	585	523	429	323
Current Assets	18,324	19,433	20,196	24,400	27,972
Inventories	4,568	3,047	2,429	3,146	3,490
Trade receivables	3,918	4,820	3,188	4,194	4,072
Cash & cash equivalents	7,439	9,460	13,008	14,978	18,126
ST Loans & advances	2,168	1,872	1,337	1,848	2,050
Other current assets	232	235	235	235	235
Total Asset	21,068	22,288	23,008	27,231	30,689

Cash Flow Statement

Fig in Rs mn	CY18	CY19	CY20E	CY21E	CY22E
PBT (Reported)	10,984	11,469	8,288	12,525	14,061
Depreciation	556	697	780	888	1,008
Interest Expenses	11	12	12	12	12
Other adjustments	36	-12	0	0	0
Operating Cash flow before WC change	11587	12166	9080	13425	15081
Changes in Working capital	-1,611	68	1,371	-788	118
Cash from Operating activities after WC	9,976	12,234	10,450	12,637	15,199
Tax Paid	-3,901	-3,195	-2,134	-3,225	-3,621
Cash Flow from Operating activities	6,076	9,039	8,316	9,412	11,578
Purchase of Fixed assets	-804	-755	-800	-1,000	-1,000
Cash Flow from Investing Activities	-804	-755	-800	-1,000	-1,000
Interest paid	-11	-12	-12	-12	-12
Dividend Paid	-5,664	-6,250	-3,956	-6,429	-7,418
Cash Flow from financing activities	-5,675	-6,262	-3,968	-6,441	-7,430
Total Increase/(decrease) in cash	-403	2,021	3,548	1,971	3,148
Opening cash & cash equivalents	7,842	7,439	9,460	13,008	14,978
Closing Cash & cash equivalent	7,439	9,460	13,008	14,978	18,126

Key Ratios

Y/E Dec (Rs mn)	CY18	CY19	CY20E	CY21E	CY22E
Valuation Ratio (x)					
P/E	15.6	13.4	18.0	11.9	10.6
P/CEPS	14.5	12.3	16.0	10.9	9.7
P/BV	9.5	8.1	7.0	5.9	5.1
Dividend Yield(%)	4.5%	4.9%	3.6%	5.8%	6.7%
EV/Sales	2.65	2.61	3.53	2.50	2.18
EV/EBITDA	9.65	8.79	11.57	7.59	6.58
Per share data (Rs)					
EPS	7.2	8.4	6.2	9.4	10.6
Cash EPS	7.7	9.1	7.0	10.3	11.6
DPS	5.0	5.5	4.0	6.5	7.5
Book Value	11.8	13.8	16.0	18.9	22.0
Returns (%)					
RoCE	68.3	68.5	43.4	55.3	52.6
RoE	64.8	65.3	41.7	53.7	51.6
Turnover Ratio (x)					
Asset Turnover	1.9	1.8	1.2	1.5	1.5
Inventory Days	84.6	66.5	77.0	73.4	73.0
Receivable days	36.6	45.4	42.0	40.0	35.0
Payable days	121.3	115.7	125.0	125.0	122.0
Cash Conversion Cycle	-0	-4	-6	-12	-14

Company Overview

Castrol India (CSTRL) – a 51% subsidiary of British Petroleum plc – is the largest private-sector lubricant player in India. The company was founded as an overseas branch of a British company and started operations as a trading unit and was renamed as Castrol in 1960. CSTRL caters to automotive, industrial and marine and energy segments and derives major chunk of revenue from the automotive segment (~90%). The company is a market leader with ~22% share in the automotive lubricant segment that has historically been dominated by the PSUs. CSTRL has 3 manufacturing plants in India and the largest distribution network comprising of 350 distributors.

The company is the market leader in retail automotive lubricant segment, and its brands include Castrol EDGE, Castrol MAGNATEC & Castrol GTX for (passenger cars), Castrol Power 1 & Castrol Active (motorcycles) and Castrol CRB, Castrol RX & Castrol VECTON (trucks). CSTRL also offers a complete range of products for industrial applications and it is the market leader in corrosion preventives and metal cutting fluid segment. Its products include gear oils, hydraulic fluids, forming oils, greases, compressor oils and chain oils.

Shareholding Pattern

Holder's Name	% Holding	Key Institutional Shareholders	% Holding
Promoter	51.02	Life Insurance Corporation of India	10.32
Non-Institutions	18.87	Aditya Birla Sun Life Trustee Private Limited A/C	1.31
Insurance companies	12.97	Murray International Trust Plc	1.42
Foreign Portfolio Investors	11.46	J P Morgan Funds	1.33
Mutual Fund	4.47		
Financial Institutions/Banks	1.1		
Alternate Investment Funds	0.11		

Source: Bloomberg; RSec Research

Comparison Valuation (Consensus)

	Consensus -EPS				P/E		
	Price	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Castrol India Ltd	109	5.9	7.7	8.9	18.5	14.2	12.3
Britannia Industries Ltd	3,785	76.8	82.7	94.9	49.3	45.8	39.9
Colgate Palmolive (India)	1,454	31.7	35.3	39.7	45.9	41.2	36.6
Dabur India Ltd	514	9.3	10.7	12.2	55.5	47.8	42.1
Emami Ltd	349	11.4	12.9	14.0	30.7	27.2	24.9
Godrej Consumer Products Ltd	684	16.1	18.1	20.5	42.5	37.8	33.3
Hindustan Unilever Ltd	2,166	35.5	42.8	48.7	61.1	50.6	44.5
ITC Ltd	167	11.2	13.2	14.3	14.9	12.7	11.7
Jyothy Labs Ltd	142	5.4	6.2	7.1	26.4	23.1	19.9
Marico Ltd	365	8.8	9.8	10.8	41.7	37.4	34.0
Nestle India Ltd	15,731	224.7	265.2	301.1	70.0	59.3	52.2
Varun Beverages Ltd	683	9.5	23.7	30.9	71.9	28.8	22.1
United Spirits Ltd	515	8.3	14.1	16.0	61.8	36.6	32.2
United Breweries Ltd	973	8.4	22.3	31.5	115.7	43.7	30.9
Asian Paints Ltd	2,073	27.3	35.5	41.4	75.8	58.4	50.0
Berger Paints India Ltd	606	6.6	8.8	10.6	92.2	68.6	57.4
Bata India Ltd	1,377	16.8	33.3	37.0	82.1	41.4	37.2
Jubilant Foodworks Ltd	2,288	15.1	36.7	45.8	151.7	62.3	49.9
Page Industries Ltd	20,660	225.5	399.5	467.2	91.6	51.7	44.2
Shoppers Stop Ltd	176	-16.0	-5.7	4.3	-11.0	-30.6	40.9
Titan Co Ltd	1,224	11.1	21.4	25.1	110.3	57.1	48.8
Pidilite Industries Ltd	1,501	20.7	27.6	31.8	72.5	54.4	47.2
Average					64.4	40.7	38.1

Source: Company, RSec research

Commercial Vehicle



Source: Company, Rsec Research

MotorCar Engine Oil



Source: Company, Rsec Research

Motorcycle Brands



Source: Company, Rsec Research

Change in Ratings

We have now only **BUY and SELL** Recommendation and have discontinued HOLD Recommendation.

We now have **2 Year Target Price** and have discontinued with 1 year Target Price.

Score	For < 5	Red	High Risk	For 5	Blue	Medium Risk	For > 5	Green	Low Risk
Total Score (%)	For < 50	Red	High Risk	For 50	Blue	Medium Risk	For > 50	Green	Low Risk

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