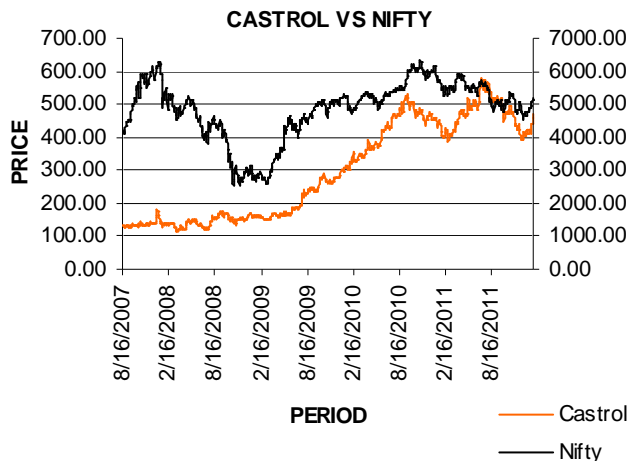


Castrol India Ltd

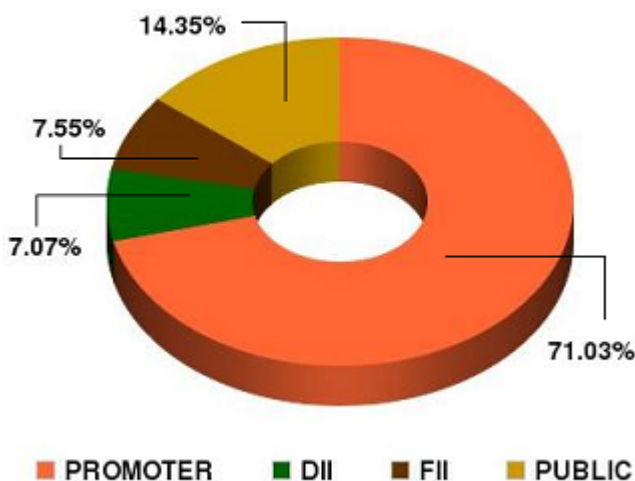
NEUTRAL



Stock Data

CMP	475.05
NSE Code	CASTROL
BSE Code	500870
Bloomberg Code	CSTRL:IN
Reuters Code	CAST.NS
52 Week High	588.40
52 Week Low	369.20
Market Cap (cr)	11716.15
Face Value	10.00
DPS	15.00
M Cap/Sales	4.284 times
Stock Beta	0.620
PE Multiple	24.46
P/BV	21.23
EV/EBITDA	14.55
Downside risk	High

SHAREHOLDING PATTERN



Company Description

Castrol India Ltd is a well established lube player in India for the past 100 years. Over the years the company has made its imprint in the Indian market by emerging as the second largest player in the Indian Lubricant Industry and is the market leader in the Retail Automotive Lubricant segment. The company currently has 70.92% of the equity held by Castrol Limited UK (part of the BP Group). From a minor oil company, with a share of about 6% in 1991, Castrol India has grown to become the second largest lubricant company in India with a market share of around 22% currently. The company has leadership positions in most of the segments in which it operates including passenger car engine oils, premium 2-stroke and 4-stroke oils and multigrade diesel engine oils. Castrol India has the largest manufacturing and marketing network amongst the lubricant companies in India. The company has 5 manufacturing Plants across the country, including a state-of-the-art plant in Silvasa. The company reaches its consumers through a distribution network of 270 distributors, servicing over 70,000 retail outlets.

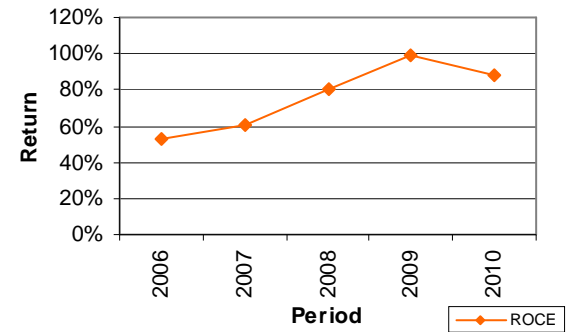
Lubricants – Steering India's Growth forward

The lubricant industry is one among the few industries which has not evolved much in the past 100 years. The Indian lubricant industry is around Rs.17, 000 crores in size and is growing at approximately 4-5 per cent per annum. It is the fifth-largest lubricant market in the world. The top four players — Indian Oil Corporation Limited (IOCL), CIL, Bharat Petroleum Corporation Limited (BPCL) and Hindustan Petroleum Corporation Limited (HPCL) — control 70 per cent of the market. The rest is shared by both regional and global players. CIL commands approximately 20 per cent market share. The growth of the lubricant industry is directly linked to the economic activity in the country. With Indian economy expecting to maintain its growth momentum, in the next two decades, it can be assumed that the lubricant industry would be a net beneficiary in the onset of the long term prospects looking brighter than ever. The lubricant industry has managed to fare well even in difficult times. The major slice of the revenue in the lubricant industry emerges from the auto segment followed by Industrials and the Marine and Energy.

Recent Trends

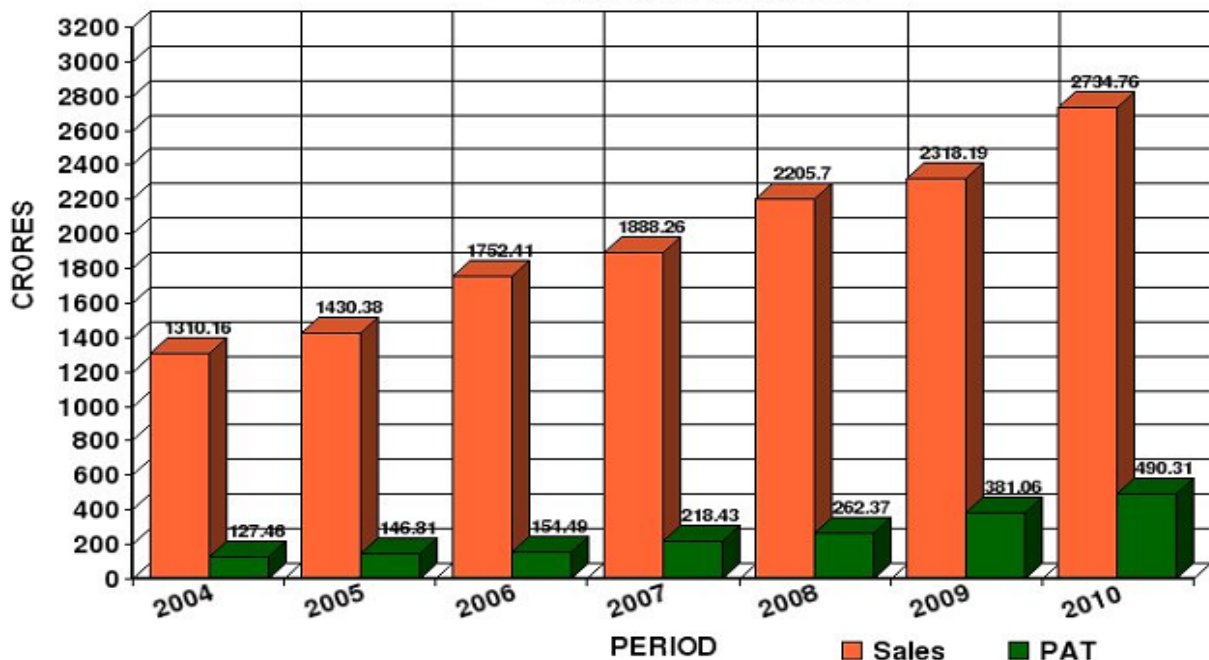
In the recent times, competition has intensified among the players in the industry. Lubricants are currently one among the most profitable products in the hydrocarbon space.

Return On Capital Employed



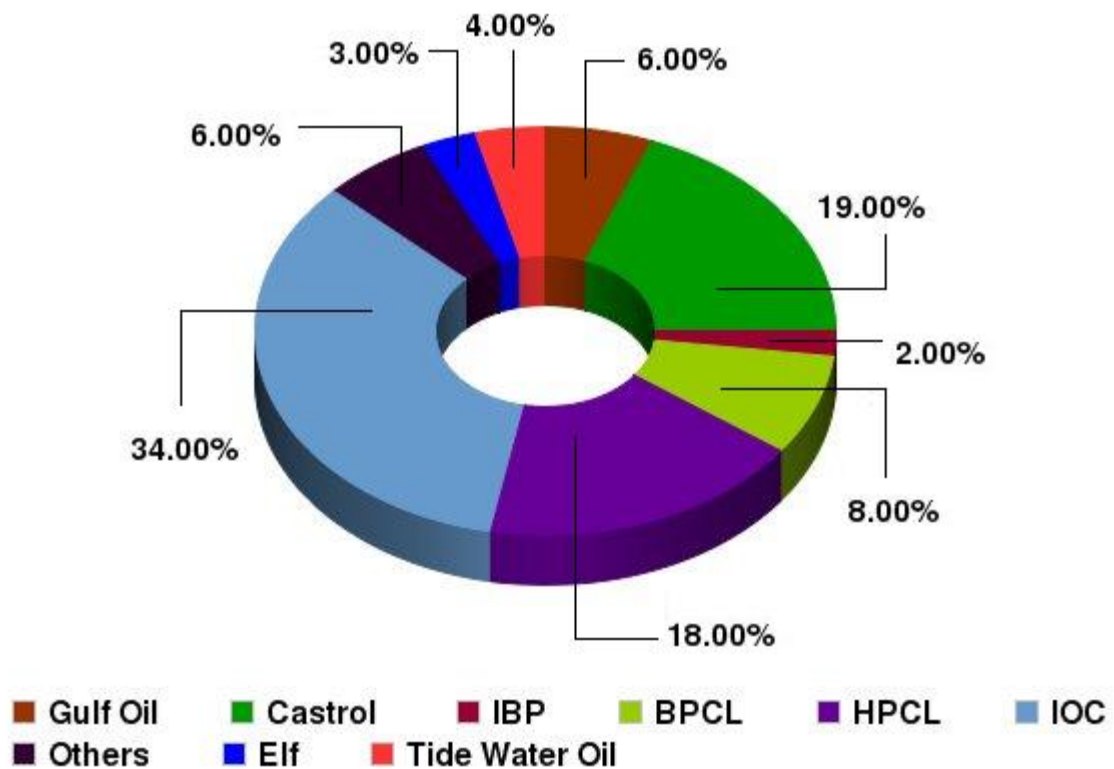
Strong entry barriers continue to remain in the segment and going forward, we expect the situation to remain atleast for the foreseeable future. Traditionally the major portion of the revenue used to come from the petrol stations etc. As urbanization has become the norm in recent times, OEM (Original Equipment Manufacturers) Dealers and authorized workshops are now becoming the major players in the lube distribution space. Rising income levels, availability of affordable finance and the arrival of new automobile models does ensure that industries associated with the auto industry are likely to thrive in the coming years.

TOPLINE VS BOTTOMLINE



Source: 2010 Annual Report of Castrol India Ltd

MARKET SHARE OF LUBE PLAYERS



Castrol India – A Pricy pick within the Lubricant Space

The company has demonstrated over time its ability by emerging as a market leader in the lubricant space. With its parentage from BP coupled with its pan India presence for the past 100 years, the company is very much familiar with the changing Indian scenario. We feel that the company is valued pick in the lubricant space due to certain factors that is likely to strengthen the underlying economics of the company in the years ahead.

- Improving Market Share:** One of the greatest beneficiaries of the auto boom that is gaining momentum in the recent times is Castrol India. Though lubricant companies in general have all been beneficiaries, Castrol could gain an extra mile in the journey by expanding its market share as well. From a meager share of just 6% in 1991, the company has been able to increase its market share to 20% which is a remarkable achievement in just a span of 20 years. These all indicate that the company has a notable competitive advantage over its peers.
- Strong Brand Equity:** The Company has a strong brand name in the 2 wheeler and the passenger vehicle space. The flagship "Activ" brand is currently a major player in the two wheeler space. With its strong brand equity and parentage it has successfully been able to make tie ups with OEMs, foreign car companies making their debut into India and authorized workshops thus securing a position in the foreign vehicle niche segment.
- Generic Product:** The Company manufactures a very generic product which has continuous usage all throughout the year. Strong demands from the existing customers are likely to keep on propping up the revenues even on the onset of a severe recession. We are also not anticipating major change in the capex spends going forward.

- **Parentage and Technology:** This is one of the strongest contentions in favor of the company that makes us enthusiastic on its long term prospects. The auto industry is evolving at a faster pace ever than before. With foreign players making their advent into the Indian markets, Castrol is aggressively making tie ups with these companies thus consolidating its position in the higher segment of the auto sector. This is mainly due to the fact that Castrol has access to superior technology via its UK parent BP. Stricter emission norms from time to time are all situations which should work out in the company's favor in the long run.
- **A concentrated Product Portfolio:** Though there are strong arguments in the investment community against a concentrated product portfolio, we feel that it is not always a wise strategy that can be replicated in any business. For a stock to be a good pick, the product should have a strong brand value, superior profit margins and consistently paying high returns on equity without relying on excess debt and progressively increasing market share with ample scope for growth within an industry whose boundaries are currently expanding could well be the right pick for the long term perspective.

Risk and Concerns

- **High Raw Material Cost:** The surge in crude oil prices in the recent months has added pressure on the operating margins of the company. Though the company has somehow managed to pass on the price hikes to the ultimate consumers, some peers were not willing to raise the prices thus widening the gap between similar products produced by competitors.
- **High Competition:** Competition has intensified in the sector in recent times. Though the company manages to still stay on top with its superior product portfolio, revenue growth could be slowed down due to the impact of high competition.
- **Long Oil Drain Intervals:** With the engine quality improving over time, the lube to fuel ratio is likely to reduce in the long term. This could impact the commercial vehicle segment which at present has the least upgraded engines in the auto sector.
- **Price Undercutting:** Many PSU players in the segment have resorted to a strategy of increasing volume rather than value thus putting Castrol's volume and market share under pressure. This would eventually lead to all companies in the sector bearing the burden.

Castrol India - A solid and promising pick available at fair value.

We have always been optimistic on companies which produce products that are not subject to major change over time resulting to lower capex and R&D spends on the company's side. These kind companies enjoy the strong franchise value of their products and over time emerge as wealth creating machines. Though these stocks usually trade at a premium to the broader indices, we believe that occasionally you get such stocks at a reasonable valuation when extreme pessimism reigns in the markets. The company with its long term presence in India is well positioned to take advantage of India's fast growing and evolving Lubricant Industry. There are many notable points in favor of the company which makes it our choicest pick in the lubricant space which we will discuss shortly.

Though the lube industry with an average growth rate of just 5% on a yearly basis can be generally categorized under the slow growing industry, we are generally enthusiastic of stocks that are increasing their market share in these industries mainly because they are likely to become the market leaders of tomorrow and slow growing industries generally have a much more longer life cycle and are much more predictable in the long term.

The lube industry's 100 year parentage substantiates our point. Though we are not pretty optimistic of the oil industry in general, the prospects of the lubricant industry a sub sector of the oil industry are bright in the light of India's growth story which is still maintaining its momentum. The lack of government intervention and superior profit margins with few players are all positive signs. Rising income levels, availability of affordable finance and arrival of new models into the Indian markets are all factors that ensure that the demand for passenger cars and two wheelers will grow at a robust pace in the years ahead. As long as these factors remain intact, we can moreover assume with precision that the lubricant industry is likely to keep on expanding. With the advent of stricter emission norms, and the onset of foreign companies making their debut into the Indian auto space, auto companies are now upgrading their engines at a much faster pace. The lubricant companies have to keep on altering their products with the changing market scenario to suit the more advanced engines that are being manufactured in a regular basis.

Local PSU players in the segment are currently not in the position to take full advantage of this situation mainly due to the fact that they lack the expertise to develop high quality lubes to cater to the industry in the auto space. This is where the company has an added advantage over its competitors. Castrol India with the help of its parent BP is in a much better position and we believe that this vacuum would be easily materialized into revenues in the coming years.

On the valuation perspective, we feel that the company is currently trading at the higher end of its fair value. Though the stock was available at a reasonable valuation a month ago, sudden speculative buying into the stock has sent the valuations to the higher end of the fair value zone. We feel that investing at this point would put the investor into a precarious situation with upsides limited and potential downsides more of a probability. We strongly suggest that investors avoid investing in such a situation. Therefore we are "NEUTRAL" on the stock at this point in time. However we would wait for the right time and become bullish on the stock if the stock corrects 15-18% from these levels.

FINANCIALS

CASH FLOW STATEMENT	FY09A	FY10A	FY11E	FY12E	FY13E
CASH FLOW FROM OPERATING ACTIVITIES					
Net Profit before Tax	580.80	737.84	768.27	892.99	978.02
Depreciation	27.18	24.33	28.91	32.50	36.58
Others	(39.53)	(247.41)	(218.65)	(269.56)	(285.69)
Net cash flow from operating activities	568.45	514.76	578.53	655.93	728.90
CASH FLOW FROM INVESTING ACTIVITIES					
Purchase of fixed assets	34.65	25.75	25.75	39.85	45.32
Increase in Investments	(0.37)	(0.52)	0.00	0.00	0.00
Others	(52.33)	(36.06)	(42.32)	(76.73)	(61.19)
Net Cash used for investing activities	(18.04)	(10.83)	(16.57)	(12.68)	(15.87)
CASH FLOW FROM FINANCING ACTIVITIES					
Long Term Borrowings	(1.98)	0.00	0.00	0.00	0.00
Dividend Paid	309.10	370.92	408.01	448.81	502.67
Others	(587.40)	(781.35)	(935.06)	(1050.17)	(1116.66)
Net Cash generated from financing activities	(280.28)	(410.43)	(527.05)	(601.35)	(613.99)
NET CHANGE IN CASH & CASH EQUIVALENTS	270.13	93.50	34.91	41.90	99.04
Opening Balance of Cash Cash Equivalents	255.63	525.76	619.26	654.17	696.06
Closing Balance of Cash Cash Equivalents	525.76	619.26	654.17	696.06	795.10

FINANCIALS

PROFIT & LOSS ACCOUNT	FY09A	FY10A	FY11E	FY12E	FY13E
Income					in Crores
Net Sales	2318.19	2734.76	2973.50	3330.32	3796.56
Other Income	36.07	39.50	41.48	45.62	49.27
Total Income	2354.26	2774.26	3014.98	3375.94	3845.84
Expenditure					
Cost of Materials	1123.78	1384.67	1531.35	1681.81	1955.23
Operating and Other Expenses	619.05	625.00	683.91	765.97	873.21
Total Expenses	1742.83	2009.67	2215.26	2447.79	2828.44
EBITDA	611.43	764.59	799.72	928.16	1017.40
Interest Finance Charges	3.45	2.42	2.54	2.67	2.80
PBDT	607.98	762.17	797.18	925.49	1014.59
Depreciation	27.18	24.33	28.91	32.50	36.58
Profit Before Tax	580.80	737.84	768.27	892.99	978.02
Provision for Tax	207.54	250.02	268.89	312.55	342.31
Deffered Taxation	(7.80)	(2.49)	3.58	8.23	13.65
Reported Net Profit	381.06	490.31	495.79	572.22	622.06
Balance as per last Balance Sheet Brought Forward	50.75	31.18	40.65	35.42	35.74
Transferred to General Reserve	39.00	49.03	25.69	49.03	49.03
Dividend Paid	309.10	370.92	408.01	448.81	502.67
Corporate Dividend Tax Paid	52.53	60.89	67.32	74.05	82.94
Balance carried to Balance Sheet	31.18	40.65	35.42	35.74	23.16
Per share					
Earning Per Share	15.41	19.83	20.05	23.14	25.16
Cash EPS	16.51	20.81	21.22	24.46	26.64
Earnings Yield	3.24%	4.17%	4.22%	4.87%	5.30%
DPS	12.50	15.00	16.50	18.15	20.33
Dividend Yield	2.63%	3.16%	3.47%	3.82%	4.28%
Valuation Ratios					
P/E	30.82	23.96	23.69	20.53	18.88
P/BV	23.73	21.22	20.47	18.85	17.81
EV/EBITDA	18.35	14.55	13.87	11.91	10.76
Return on Investment					
ROCE	76.98%	88.58%	86.38%	91.80%	94.29%
ROIC	81.59%	92.97%	92.48%	98.77%	102.32%
ROTA	32.40%	37.07%	34.95%	36.47%	35.79%
Debt Equity	0.00%	0.00%	0.00%	0.00%	0.00%
Profitability Ratios					
EBITDA Margin	26.38%	27.96%	26.89%	27.87%	26.80%
PBT Margin	25.05%	26.98%	25.84%	26.81%	25.76%
PAT Margin	16.44%	17.93%	16.67%	17.18%	16.38%

FINANCIALS

BALANCE SHEET	FY09A	FY10A	FY11E	FY12E	FY13E
Sources Of Funds					
Equity Share Capital	123.64	247.28	247.28	247.28	247.28
Reserves & Surplus	371.36	306.22	326.68	376.03	412.48
Networth	495.00	553.50	573.96	623.31	659.76
Secured Loans	0.00	0.00	0.00	0.00	0.00
Unsecured Loans	0.00	0.00	0.00	0.00	0.00
Current Liabilities & Provisions					
Creditors	375.33	432.08	475.76	532.85	607.45
Other Current Liabilities	56.39	62.78	59.47	66.61	75.93
Provisions	249.45	274.34	309.24	346.35	394.84
Total Liabilities	1176.17	1322.70	1418.43	1569.12	1737.98
Application Of Funds					
Gross Block	280.52	295.47	321.22	361.07	406.39
Less: Accum. Depreciation	153.65	159.61	188.52	221.02	257.59
Impairment Provision	15.54	15.54	15.54	15.54	15.54
Net Block	111.33	120.32	117.16	124.51	133.26
Capital Work in Progress	26.13	16.57	17.40	18.27	19.18
Investments	0.52	0.00	0.00	0.00	0.00
Deferred Tax Asset	34.62	37.11	33.53	25.30	11.65
Current Assets Loans and Advances					
Inventories	208.63	244.20	267.62	315.16	341.69
Sundry Debtors	160.60	178.43	208.15	248.12	265.76
Cash and Bank Balance	525.76	619.26	654.17	696.06	795.10
Other Current Assets	3.55	5.06	9.36	17.32	32.04
Loans & Advances	105.03	101.75	111.05	124.38	139.30
Total Assets	1176.17	1322.70	1418.43	1569.12	1737.98

Analyst Certification

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