Castrol India

Accumulate

DART
DOLAT ANALYSIS & RESEARCH THEMES
IN-DEPTH• PRECISE• ACTIONABLE

Result Update

Volumes lower than estimates, Higher realizations negate increase in input cost; Maintain Accumulate

CSTRL's Q1CY19 volumes were marginally below our estimates at 50.4 TKL. Revenue increased 5% YoY and decreased by 5.5% QoQ, due to growth in the personal mobility segment, focus on channels, and new premium products. Gross spreads rose by 2% on a sequential basis. We expect spreads to remain stable/expand going forward, as CIL has already hiked prices in Q1CY19. CSTRL's management is pessimistic about its performance in H1CY19, due to the slowdown in economic activities. However, it is confident of outperforming the industry growth rate of 3% - 4% on a full year basis. Volume growth with spreads performance will be the key monitorable. Given significant under performance of the stock price for a prolonged period, CSTRL business performance in the next two quarters will be crucial for the long term stock outlook. We maintain Accumulate, with a target price of ₹ 174, to trade at 20x CY20 EPS.

Volume growth – key monitorable

CSTRL reported a volume de-growth of 2% QoQ and 6.7% YoY. The personal mobility segment grew, whereas the commercial and industrial segment de-grew, which was in line with the industry. The industry de-grew 9%. Given the revival in the commercial space and the agriculture market, and increase in new product launches and product mix in the personal mobility segment, CSTRL is likely to outperform and grow at a CAGR of 5% for CY18-CY20.

Expanding reach with brand thrust – key to profitability

CSTRL has been expanding distribution aggressively to increase its touch points. The company is also investing in brands and retail distribution. The brand strength of CSTRL has created a strong product recall. The brand power also ensures premium pricing – key to profitability. We expect CSTRL to maintain its investments in the distribution chain and advertising to get "profitable volume growth". In Q1CY19, it spent an additional ₹ 200 mn in installation of dealer signage and retail shops signage.

Q1CY19 Result (₹ Mn)

Particulars	Q1CY19	Q1CY18	YoY (%)	Q4CY18	QoQ (%)
Revenue	9,762	9,271	5.3	10,334	(5.5)
Total Expense	6,932	6,528	6.2	7,160	(3.2)
EBITDA	2,830	2,743	3.2	3,174	(10.8)
Depreciation	162	143	13.3	146	11.0
EBIT	2,668	2,600	2.6	3,028	(11.9)
Other Income	211	228	(7.5)	256	(17.6)
Interest	3	7	(57.1)	3	0.0
EBT	2,876	2,821	2.6	3,281	(12.3)
Tax	1,026	1,003	2.3	1,162	(11.7)
RPAT	1,850	1,818	1.8	2,119	(12.7)
APAT	1,850	1,818	1.8	2,119	(12.7)
			(bps)		(bps)
Gross Margin (%)	53.2	53.7	(47)	52.9	31
EBITDA Margin (%)	29.0	29.6	(60)	30.7	(172)
NPM (%)	19.0	19.6	(66)	20.5	(155)
Tax Rate (%)	35.7	35.6	12	35.4	26
EBIT Margin (%)	27.3	28.0	(71)	29.3	(197)

CMP	₹ 154
Target / Upside	₹ 174 / 13%
BSE Sensex	39,067
NSE Nifty	11,748

Scrip Details

Equity / FV	₹ 4,946mn / ₹ 5
Market Cap	₹ 152bn
	US$ 2bn
52-week High/Low	₹ 203/₹ 135
Avg. Volume (no)	16,89,710
NSE Symbol	CASTROLIND
Bloomberg Code	CSTRL IN

Shareholding Pattern Mar'19(%)

Promoters	51.0
MF/Banks/FIs	17.3
FIIs	11.8
Public / Others	19.9

Valuation (x)

	CY18A	CY19E	CY20E
P/E	21.5	19.3	17.7
EV/EBITDA	13.5	11.9	10.8
ROE (%)	64.8	66.6	72.0
RoACE (%)	105.9	107.5	116.2

Estimates (₹ mn)

	CY18A	CY19E	CY20E
Revenue	39,046	41,152	44,938
EBITDA	10,708	11,975	13,212
PAT	7,084	7,878	8,624
EPS (₹)	7.2	8.0	8.7

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DOLAT CAPITAL

New product launches drive growth

CSTRL is adding new products, with improved formulations and performance across categories. The company has refreshed its portfolio of Castol Activ and added two new variants for enhanced biker experience. CSTRL is increasing the proportion of the synthetic and semi synthetic lubricants in the product basket to tap opportunity of BSVI complaint vehicles.

Capacity expansion at Silvassa

CSTRL plans to invest ₹ 1,400 mn in two years to expand capacity at Silvassa. The first phase of Silvassa plant has commenced operations, which is likely to be a long term positive for CSTRL's growth. This plant will help to upgrade technology, debottleneck for smaller packs, and expand capacity. Considering cash on books of ₹ 8,000 as on 31st March 2019, capex will be easily funded through internal accruals.

Exhibit 1: KPI's

	Q1CY19	Q4CY18	QoQ (%)	Q1CY18	YoY (%)	CY18
Volumes (in '000 KL)	50.4	54.0	(6.7)	51.5	(2.1)	213.5
Realization (₹ / L)	193.7	191.4	1.2	180.0	7.6	182.9
Cost (₹ / L)	90.6	90.1	0.5	83.4	8.7	89.3
Spread (₹ / L)	103.1	101.2	1.8	96.6	6.7	93.6
EBIDTA (₹ / L)	56.2	58.8	(4.5)	53.3	5.4	50.2
PAT (₹ / L)	36.7	39.2	(6.5)	35.3	4.0	33.2

Source: Company, DART

Valuation

Volumes are expected to improve post H1CY19, driven by personal mobility. CSTRL will be able to maintain its market share, and we expect this to be driven by expanding distribution reach and an increase in product offerings. At CMP, CIL trades at 19.3x CY19E and 17.7x CY20E earnings.

With the continued fading of valuations across the markets, we have lowered our earnings multiple to factor in the overall risk. At CMP, CSTRL is factoring most of the negatives. We maintain an Accumulate rating, with TP of ₹ 174, valuing at 20x CY20 earnings.

Q1CY19 Results

- The top line in Q1CY19 increased by 5% on a YoY basis to ₹ 9,762mn, but decreased 5.5% on a QoQ basis.
- Volumes at 50.4 TKL, was a decline of 6.7% on a QoQ basis.
- Raw material as a % of sales was 46.8% in Q1CY19, as compared to 47.1% in Q4CY18, and 46.3% in Q1CY18.
- EBIDTA has increased by 3.2% on a YoY to ₹ 2,830mn, but fell 10.8% QoQ.
- Operating margins were at 29%, a decline of 172 bps QoQ and 59.7 bps YoY.
- Net profit increased by 1.8% on a YoY basis and decreased by 12.7% on a sequential basis to ₹ 1,850 mn.

Conference Call KTA's

CSTRL growth

- Topline improvement of 5% YoY was contributed by the growth in personal mobility space, focus channels, and new premium products.
- Through careful cost control initiatives, well managed working capital, new product launches, strategic sourcing, and holding on to product mix, the company has been able to protect margins QoQ.
- Personal mobility continued to be a key growth driver, with growth in power brands and synthetics. The company gained market share in personal mobility.
- The commercial and industrial segments degrew, which was in line with the market. The personal mobility, which includes cars and bikes, increased continuously, and grew in a single digit, whereas CVO and industrial de grew in a single digit.

Market growth

- Overall the lubricant market de grew 9% in Jan-Feb and it de-grew 5% in the preceding quarter. In the last six months, the lubricant market de-grew. CSTRL de-grew 2% in Jan-Feb.

New product launches and tie ups

- In Q1CY19, Castrol Activ range of two wheeler engine oils portfolio was refreshed with formulation changes and two new variants were also launched, in line with changing needs of bikers and providing 3X protection across all stages of riding.
- Last quarter, CSTRL tied up with Mahindra and Mahindra, and this quarter signed strategic agreement with Ford India, including supply of engine and transmission oils to their dealerships in India, and working jointly to develop and co-engineer products to further enhance performance efficiency of Ford vehicles.
- CSTRL has invested strongly in brands and retail distribution.
- In difficult times, CSTRL provided extra credit support to the dealers and distributors, which they pulled back this quarter.

Other expenses

- Operating expenses were higher QoQ, due to CSTRL's investments in brand and increase in salaries which raised employee cost. Also, there was more feet on the street in terms of distribution strength, inflation in selling and distribution expenses, and increase volumes in OEM (meant more payment to pay joint royalty, which is a positive), altogether increased the other expenses.
- Advertisement expenses were 3%-4% of turnover.
- The management reviews the prices every month.

Raw material pricing

- Base oil prices are trending up in last 4-5 quarters. There was a slight decline in Q1CY19. There was also a lag effect seen in Q1CY19. Additives prices have also gone up significantly in the past year. Forex has declined 9% YoY. All of these have contributed to an increase in input cost.
- If crude oil rises above $70/bbl then there may be an increase in base oil prices.

Threat of electric vehicles

- Electric vehicle threat will not be seen in in the near term. The 3W, 2W and city buses will be converted to EV. There will be an opportunity for CSTRL to supply coolants, greases, transmission fluids.
- The commercial and industrial segment will still continue to use lubricants. Also, passenger car transition is delayed due to a huge investment involved.
- There is no threat from EV as growth will come from passenger car, commercial, industrial segment, and 2 wheeler segment for the next 10 years.
- CSTRL has also made use of opportunity of BS VI conversion. In the last 18 months, it introduced synthetic oils to be used in BS VI compliant vehicles.

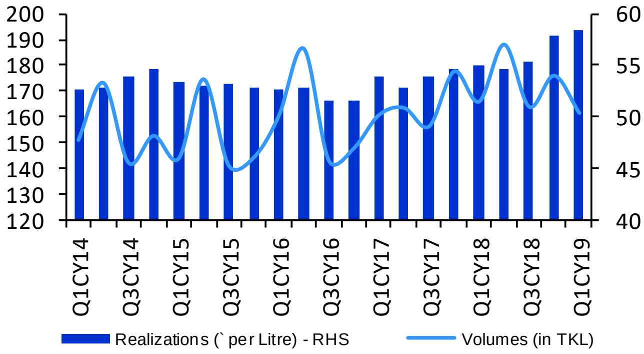
Capex

- Last quarter, the company announced a capex of ₹ 1,400 mn for the Silvassa plant expansion, which will take place over two years.
- In current quarter, it added ₹ 200 Mn capex for installation of signages, which can be capitalised and will depreciate over three years. The signages are dealer signages and retail shops which hold CSTRL signage.

Factors driving long-term growth for CSTRL

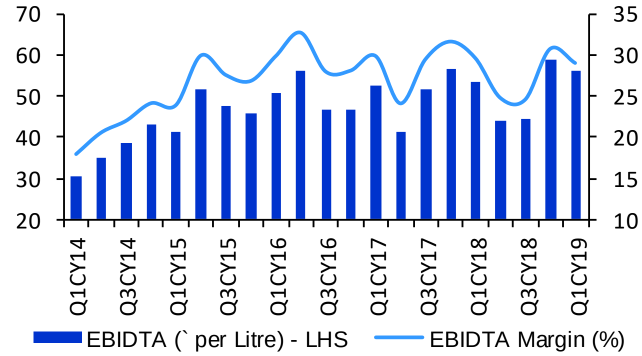
- First Phase of Silvassa plant has started operations, which shows the management’s confidence of long-term growth in India.
- The commercial activity revival will be a long-term positive for the company.
- The agri-market is also under pressure. Rural uptick is not happening. All these are putting pressure on volumes.
- The gross margins are expected to be in the range of ₹ 90/L-₹ 100/L, due to an increase in product mix.
- About 90 mn new vehicles are expected to be added in next five years.
- Q1CY19 has been a bad quarter, Q2CY19 is expected to be better than Q1, due the agricultural season. From Q3CY19 onwards, the management sees a positive impact. The management is pessimistic for H1CY19, but expects to be CY19 to be good.

Exhibit 2: Volumes and realisation



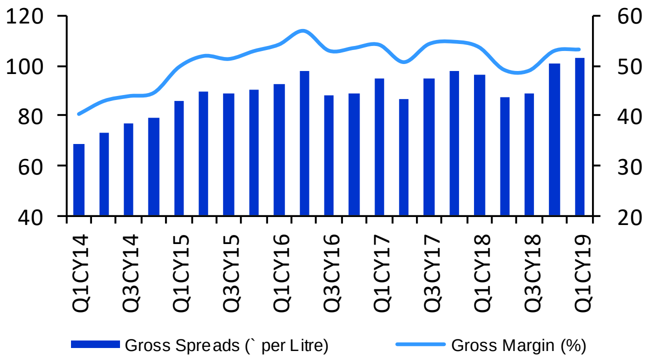
Source: Company, DART

Exhibit 3: EBIDTA spread and EBIDTA margin



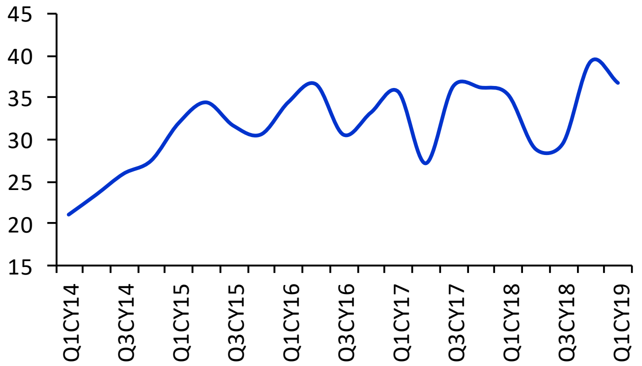
Source: Company, DART

Exhibit 4: Gross spread and gross margin



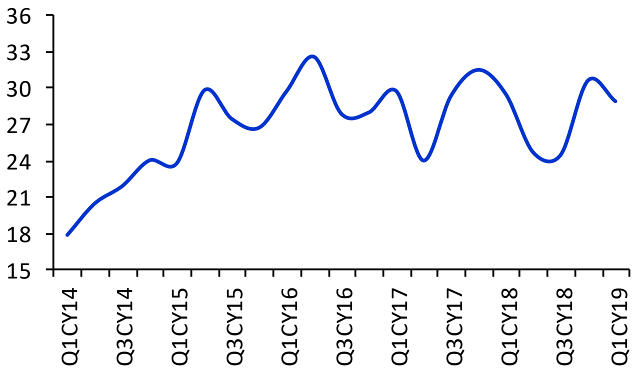
Source: Company, DART

Exhibit 5: PAT/L



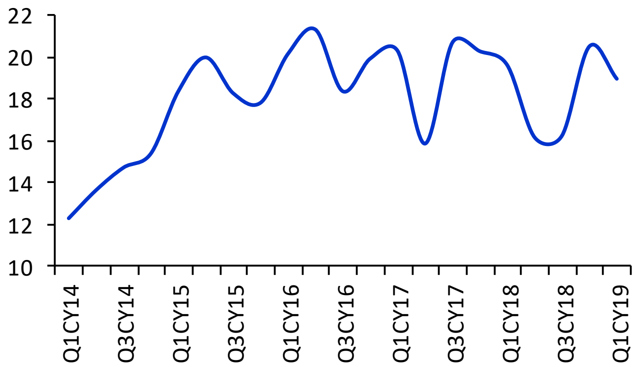
Source: Company, DART

Exhibit 6: OPM %



Source: Company, DART

Exhibit 7: NPM %



Source: Company, DART

Profit and Loss Account

(₹ Mn)	CY17A	CY18A	CY19E	CY20E
Revenue	**35,844**	**39,046**	**41,152**	**44,938**
Total Expense	**25,512**	**28,338**	**29,177**	**31,726**
COGS	16,659	19,066	19,342	21,121
Employees Cost	1,956	2,034	2,140	2,382
Other expenses	6,897	7,238	7,695	8,224
EBIDTA	**10,331**	**10,708**	**11,975**	**13,212**
Depreciation	455	556	639	728
EBIT	**9,876**	**10,152**	**11,336**	**12,484**
Interest	12	11	16	16
Other Income	837	843	800	800
Exc. / E.O. items	0	0	0	0
EBT	**10,701**	**10,984**	**12,120**	**13,268**
Tax	3,783	3,901	4,242	4,644
RPAT	6,918	7,084	7,878	8,624
Minority Interest	0	0	0	0
Profit/Loss share of associates	**0**	**0**	**0**	**0**
APAT	**6,918**	**7,084**	**7,878**	**8,624**

Balance Sheet

(₹ Mn)	CY17A	CY18A	CY19E	CY20E
Sources of Funds				
Equity Capital	4,946	4,946	4,946	4,946
Minority Interest	0	0	0	0
Reserves & Surplus	5,256	6,711	7,067	7,013
Net Worth	**10,202**	**11,657**	**12,013**	**11,958**
Total Debt	0	0	0	0
Net Deferred Tax Liability	(552)	(533)	(551)	(551)
Total Capital Employed	**9,650**	**11,124**	**11,462**	**11,407**
Applications of Funds				
Net Block	**1,390**	**1,860**	**2,471**	**2,993**
CWIP	573	350	250	250
Investments	0	0	0	0
Current Assets, Loans & Advances	**17,256**	**18,325**	**20,173**	**20,438**
Inventories	3,196	4,568	4,284	4,678
Receivables	2,850	3,918	3,382	3,694
Cash and Bank Balances	7,842	7,439	10,290	10,016
Loans and Advances	2,400	1,259	1,133	1,019
Other Current Assets	968	1,142	1,084	1,030
Less: Current Liabilities & Provisions	**9,568**	**9,411**	**11,433**	**12,274**
Payables	6,066	5,840	7,419	8,101
Other Current Liabilities	3,502	3,571	4,014	4,173
Net Current Assets	7,688	8,913	8,741	8,164
Total Assets	**9,650**	**11,124**	**11,462**	**11,407**

E – Estimates

Important Ratios

Particulars	CY17A	CY18A	CY19E	CY20E
(A) Margins (%)				
Gross Profit Margin	53.5	51.2	53.0	53.0
EBIDTA Margin	28.8	27.4	29.1	29.4
EBIT Margin	27.6	26.0	27.5	27.8
Tax rate	35.3	35.5	35.0	35.0
Net Profit Margin	19.3	18.1	19.1	19.2
(B) As Percentage of Net Sales (%)				
COGS	46.5	48.8	47.0	47.0
Employee	5.5	5.2	5.2	5.3
Other	19.2	18.5	18.7	18.3
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	823.0	931.4	708.5	780.2
Inventory days	33	43	38	38
Debtors days	29	37	30	30
Average Cost of Debt	0.0	0.0	0.0	0.0
Payable days	62	55	66	66
Working Capital days	78	83	78	66
FA T/O	25.8	21.0	16.7	15.0
(D) Measures of Investment				
AEPS (₹)	7.0	7.2	8.0	8.7
CEPS (₹)	7.5	7.7	8.6	9.5
DPS (₹)	7.0	5.0	6.5	7.5
Dividend Payout (%)	100.1	69.8	81.6	86.0
BVPS (₹)	10.3	11.8	12.1	12.1
RoANW (%)	69.1	64.8	66.6	72.0
RoACE (%)	114.0	105.9	107.5	116.2
RoAIC (%)	722.9	369.6	466.7	973.9
(E) Valuation Ratios				
CMP (₹)	154	154	154	154
P/E	22.0	21.5	19.3	17.7
Mcap (₹ Mn)	1,52,324	1,52,324	1,52,324	1,52,324
MCap/ Sales	4.2	3.9	3.7	3.4
EV	1,44,482	1,44,886	1,42,035	1,42,308
EV/Sales	4.0	3.7	3.5	3.2
EV/EBITDA	14.0	13.5	11.9	10.8
P/BV	14.9	13.1	12.7	12.7
Dividend Yield (%)	4.5	3.2	4.2	4.9
(F) Growth Rate (%)				
Revenue	6.4	8.9	5.4	9.2
EBITDA	3.4	3.6	11.8	10.3
EBIT	3.5	2.8	11.7	10.1
PBT	2.9	2.6	10.3	9.5
APAT	3.2	2.4	11.2	9.5
EPS	3.2	2.4	11.2	9.5

Cash Flow

(₹ Mn)	CY17A	CY18A	CY19E	CY20E
CFO	6,093	5,495	11,738	9,671
CFI	1,514	661	3,452	(1,250)
CFF	(6,567)	(5,674)	(7,538)	(8,695)
FCFF	5,738	4,715	10,588	8,421
Opening Cash	1,116	2,155	2,637	10,290
Closing Cash	2,155	2,637	10,290	10,016

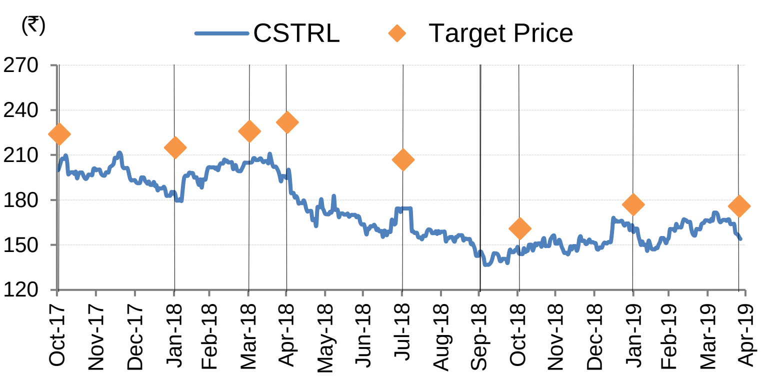
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)
Nov-17	Accumulate	224	202
Feb-18	Accumulate	215	184
Apr-18	Accumulate	226	205
May-18	Buy	232	195
Aug-18	Buy	207	174
Nov-18	Accumulate	161	144
Jan-19	Accumulate	177	159
Apr-19	Accumulate	176	155

*Price as on recommendation date

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