BODHI CAPITAL

An Initiative of ABC | INVESTMENTS

Castrol

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Castrol

CMP: Rs. 122.35

Market Cap: Rs. 12,176 cr

Holding Period: 5 years

Date: 29/08/20

Rating: HOLD

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Investment Thesis

A Slow Grower with a generous dividend, selling at a fast growers valuation

Despite being a fundamentally strong and stable enterprise, offering a generous dividend Castrol India Ltd, leaves a lot to be desired due to its' valuation being akin to that of a fast growing business. This, coupled with the uncertainty surrounding the likelihood of the business' transition from that of a slow grower to a stalwart and it's lack of secure dividends, due to high payout ratios and volatility of revenues are the reasons behind the HOLD rating given to this stock

Company Overview

Castrol India, a 51% subsidiary of British Petroleum plc, is the largest private sector lubricant player in India. The company's history in India dates back to 1910 when certain automotive lubricants from CC Wakefield & Co made an entry in the domestic market. The company caters to the automotive, industrial and marine & energy segments. It derives majority of its revenues from the automotive segment (~90%), with commercial vehicles segment at ~45%, followed by passenger cars and 2W segments which together contribute ~45% of overall sales. The company is market leader with ~22% share in the automotive lubricant segment that has historically been dominated by PSU companies. Castrol operates 3 manufacturing plants in India and has the largest distribution network of 420 distributors, servicing over 110,000 retail sites.

Key Business Segments

Castrol’s business can be classified under three components:

1) Automotive Lubricants
2) Industrial Lubricants
3) Energy & Marine Lubricants

Automotive Lubricants

The company markets its automotive lubricants under Castrol and BP brand names. The four major players - Castrol, IOC, BPCL and HPCL- contribute approximately 55% of the total market in volume terms. Company continues its close association with its Key Strategic OEM partners, especially Maruti Suzuki, Volkswagen group, Tata Motors, Ford and JCB.

Industrial Lubricants

The Company drove the Industrial business through acquisition of new customers and introduction of new products, despite a tough external environment, but with global OEMs continue their focus in India, growth prospects are likely to get bolstered.

The company provides metal working fluids and high performance lubricants; and lubricants for original equipment manufacturers franchised workshops.

Marine & Energy Lubricants

The Company focuses on providing best- in-class products and services and offering value-added services, along with best practices from its marine businesses globally, strengthening customer confidence.

With the imminent implementation of IMO global sulphur cap effective January 2020, the Company recently launched Cyltech 40 SX - a fully miscible, compatible, OEM approved and Marpol 2020 compliant lubricant to help adhere to this compliance requirement.With cargo traffic in ports of India continuing to see an increase and with distributors for all segments of customers (including spot market), new product introduction and better availability, the Company has increased its outreach and intends to leverage its brand equity to penetrate untapped markets.

Management

R Gopalakrishnan- Independent Director & Chairman

Uday Khanna- Independent Director

Sangeeta Talwar- Independent Director

Rakesh Makhija- Independent Director

Sashi Mukundan- Nominee Director

A S Ramchander- Nominee Director

Sandeep Sangwan- Managing Director

Rashmi Joshi- Chief Financial Officer & Wholetime Director

Jayanta Chatterjee- Wholetime Director (Supply Chain)

Management

R. Gopalkrishnan- He has been a professional manager from 1967. He has served as Chairman of Unilever Arabia, as MD of Brooke Bond Lipton and Vice Chairman of Hindustan Lever, as ED of Tata Sons and several Tata companies. He also serves as an independent director of listed companies, Akzo Nobel India, Castrol India, and Hemas Holdings PLC, Sri Lanka.

Rashmi Joshi- 25 years of **experience** in the finance departments of FMCG, pharmaceutical, consumer durable and lubricants industries

Sashi Mukandan- Sashi Mukundan has over 36 years of experience in the oil and gas business through a variety of assignments in USA and Asia.

Rakesh Makhija- Mr. Makhija brings over four decades of significant top management experience with diversified industrial and technology companies

Management

Sandeep Sangwan- A successful career over 29 years and brings extensive business, sales and marketing expertise with him.

A S Ramchander - Over 3 decades of experience in managing a diverse portfolio of products and has experience in marketing, P&L management, business leadership, strategy, and sales. He has a blend of B2C and B2B experience and working both in emerging and mature markets

Sangeeta Talwar-During her early years with Nestle India, she helped to craft, create, launch and establish what became a marketing legend in its time - Maggi Noodles. She was perhaps the first lady in the Fast Moving Consumer Goods (FMCG) industry in India.

Uday Khanna- 30 years of experience with Hindustan Unilever in a variety of financial, commercial and general management roles both internationally and internationally.

Management Analysis

In FY 18-19 - The company spoke about revenue from operations of Company has increased by about 9% over the previous year to INR 3,905 crores.

Costs of materials were higher by about 14% over the previous year at INR 1,907 crores mainly due to rise in input costs. Operating and other expenses (excl. excise) increased by INR 42 crores as compared to the previous year mainly due to higher volume. Profit before Tax increased by about 3% over previous year to INR 1,098 crores. Tax rate for the current year has remained at nearly the same level as that of the previous year. Profit after Tax increased by 2% over the previous year to INR 708 crores.

Management Analysis

In FY 2019-2020- The company spoke about *the effect of Covid-19 which will disrupt supply chains, low absorption of fixed costs, labour crunch and production loss. The management can defer some Cap-Ex to maintain the cash position of the company. The OEMs have also stopped most of their assembly lines and hence there would be loss of revenue for the company in double digits.*

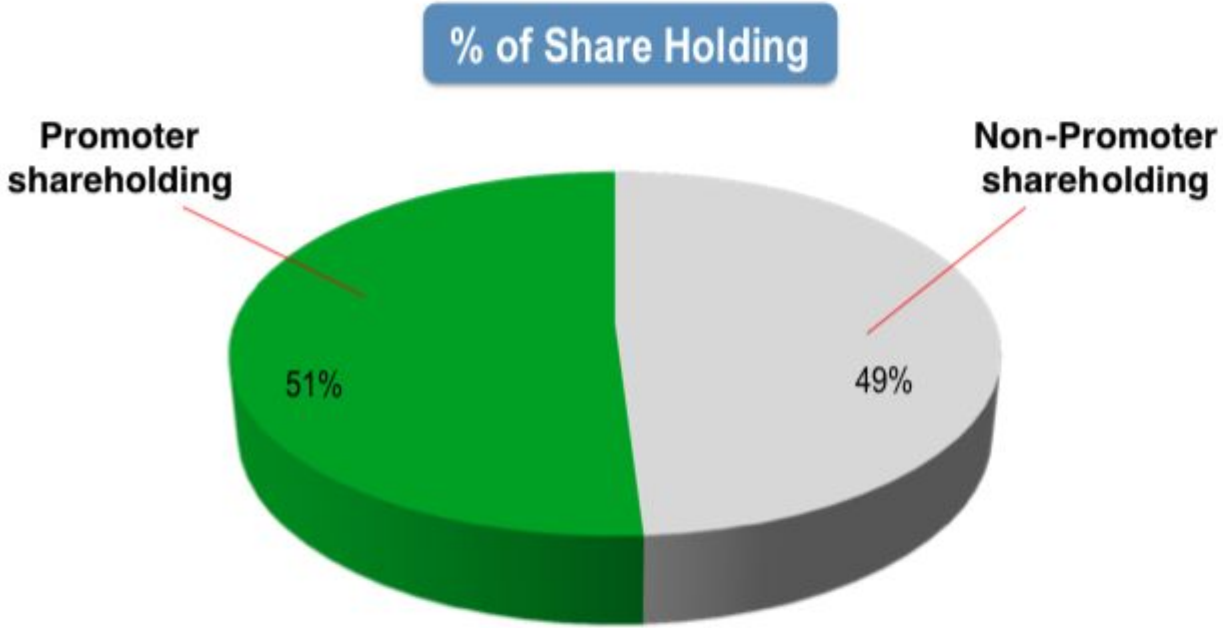
- Castrol India’s revenue dropped by 30% year-on-year to INR 688 crores. This was far worse than the marginal 0.7% revenue decline seen in 2019 due to the Auto sector slowdown. Any recovery to previous levels is not expected until the year-end FY 2021.
- *The company’s manufacturing plants have resumed operations at partial capacity. Post the partial relaxation in the lockdown by the government, the company is witnessing demand pickup for products in its two-wheeler segment.*
- The stock currently trades at around 13 times estimated its FY 2021 estimated earnings.

Management Analysis

The company's been quite transparent in their records which tell us that there hasn't been any frauds, scams or accusations of such level against the business.

The high ROCE AND ROE % of the business makes the losses due to COVID seem less scary and indicates an efficient management behind the operations.

Shareholding Pattern



Listed on BSE & NSE

Qualitative Analysis

Market Analysis

- India is the second largest lubricant consumer in the region, and third in the world, after the United States and China.
- India is a net base oil deficit market leading to large scale import of base oil and additives. This exposes the lubricants business to fluctuations in foreign exchange rates.
- The country is the fourth and sixth largest producer of commercial vehicles and passenger cars, respectively.
- The Indian lubricants market is expected to register a CAGR of around 3%, during the forecast period.
- One of the major factors driving the growth of the market is the increasing usage of high-performance synthetic lubricants.

Market Analysis

- In India, with the increasing demand for vehicles, several automakers have started investing heavily in various segments of the industry. Furthermore, the Indian government has been rolling out initiatives to attract FDI in the automotive industry, allowing 100% FDI under the automatic route. The government has also planned to introduce a new Green Urban Transport Scheme with central assistance of about INR 250 billion, to boost the growth of urban transport, along the low-carbon path, with an aim to reduce air pollution substantially.
- However, India's automotive industry has been declining from the past one year due to a continuous slump in demand, slowing economic activity, and an increase in vehicle ownership costs. The outbreak of COVID-19 has further affected the economy at present, as all the manufacturing sectors has been stopped due to lockdown.
- Thus, the aforementioned factors are expected to impact the automotive industry, which in turn will affect the growth of the lubricants demand in the country.

Market Analysis

- The country's automotive industry accounts for around 7.1% of the country's GDP, in which the two-wheeler segment accounts for a share of around 81% share, owing to the growing young and middle-class population. Additionally, the government's initiatives, such as the Make in India campaign, are helping the local and state-owned manufacturers to provide their products to consumers and offer stiff competition to international players.
- Moreover, with the consistent economic development and rising incomes, the automotive industry has been witnessing a continued shift in vehicle preferences, from two- to four-wheelers, which helps to augment the demand for passenger car motor oils (PCMO).
- Furthermore, as the companies are interested in entering the rural markets, with their improvement, the automotive industry is expected to witness further growth. A share of passenger vehicle sales originates from rural areas, especially utility vehicles and SUVs, which are used for both transporting goods and passengers.

Market Analysis

- The top three players account for around 50% of the market studied. The top companies have been utilizing competitive strategies and investments, to retain and expand their shares. Major players in the market include Castrol Limited (BP), Bharat Petroleum Corporation Limited, Gulf Oil International, HPCL, and Indian Oil Corporation Ltd, among others.

Market Analysis

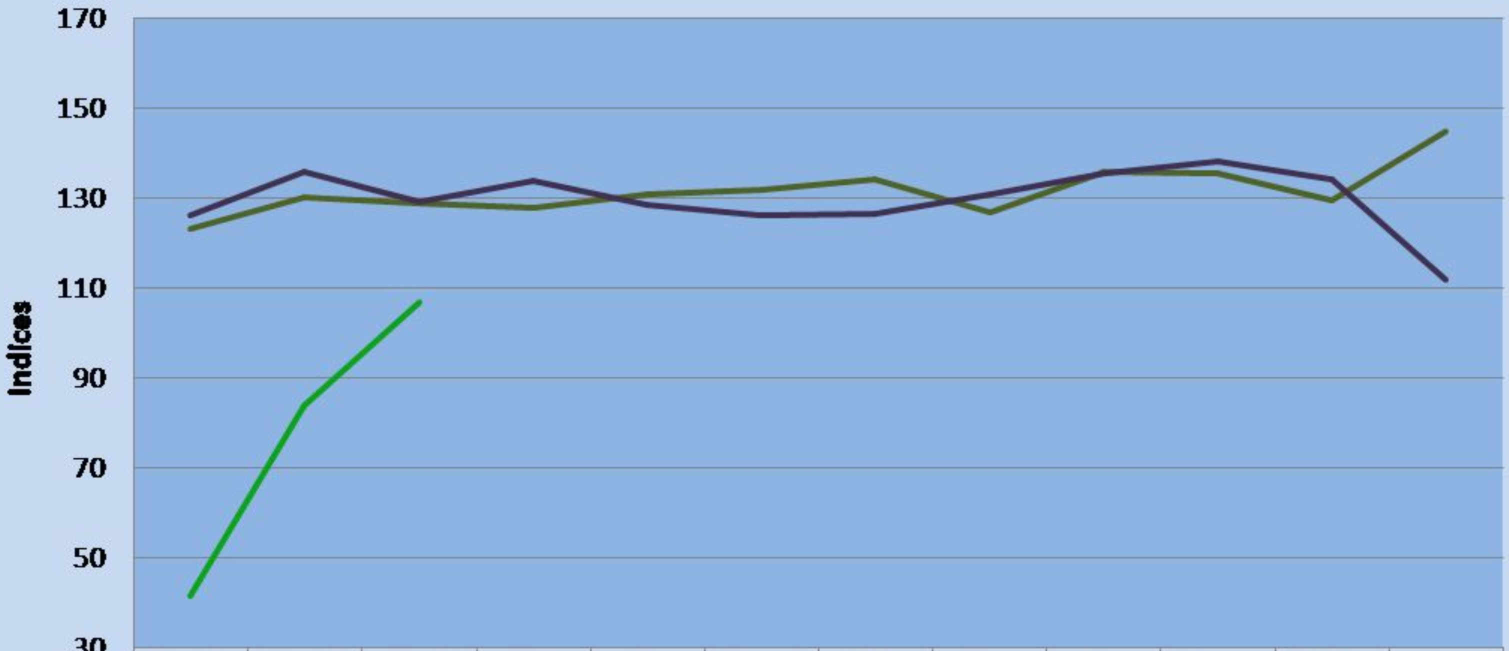
- India is a net base oil deficit market leading to large scale import of base oil and additives. This exposes the lubricants business to fluctuations in foreign exchange rates.
- Demand for automotive lubricants is driven by the expansion of vehicle population as well as the usage of vehicles in the country. Industrial lubricants demand is observed to have a strong correlation with the Index of Industrial Production (IIP), which is largely driven by economic activity. In case of marine & energy lubricants, the demand drivers include global and local ship movements, which facilitate large scale movement of cargo as well as the installed base of offshore rigs and their uptime.

Electricity: Monthly indices during 2018-19, 2019-20 & 2020-21

	Apr*	May*	Jun*	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
2018-19	153.7	164.7	159.9	162.0	167.2	162.9	166.0	147.3	150.4	150.9	137.9	160.1
2019-20	162.9	176.9	173.6	170.5	165.7	158.7	145.8	139.9	150.3	155.6	153.7	146.9
2020-21	125.5	150.6	156.2									

* The figures for April, May and June 2020 are provisional

Manufacturing: Monthly indices during 2018-19, 2019-20 & 2020-21



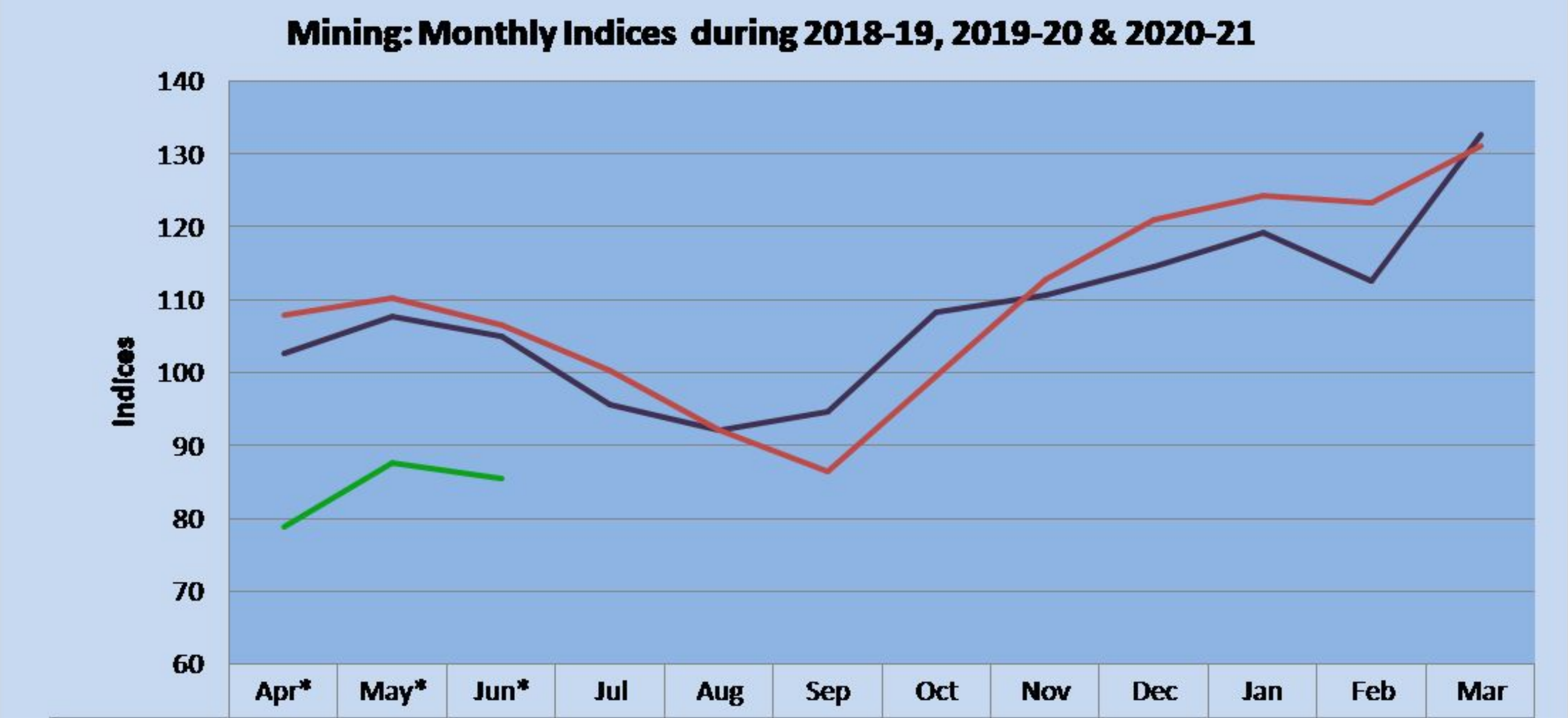
	Apr*	May*	Jun*	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
2018-19	123.1	130.1	128.6	127.6	130.6	131.6	133.9	126.8	135.8	135.5	129.3	144.6
2019-20	126.2	135.8	129.0	133.7	128.4	126.0	126.3	130.6	135.4	137.9	134.2	111.6
2020-21	41.5	83.6	106.9									

* The figures for April, May and June 2020 are provisional

General: Monthly indices during 2018-19, 2019-20 & 2020-21

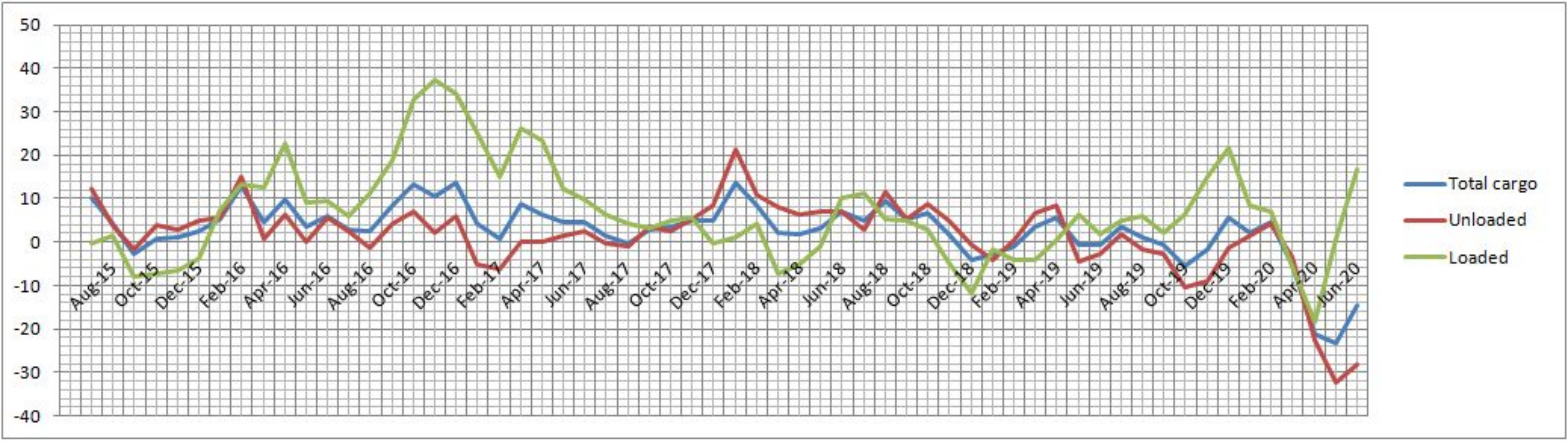
	Apr*	May*	Jun*	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
2018-19	122.6	129.6	127.7	125.7	128.0	128.8	132.8	126.1	133.9	134.4	127.6	144.1
2019-20	126.5	135.4	129.3	131.8	126.2	122.9	124.0	128.8	134.5	137.4	134.2	117.2
2020-21	53.6	89.5	107.8									

* The figures for April, May and June 2020 are provisional



	Apr*	May*	Jun*	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
2018-19	102.6	107.6	104.9	95.5	92.0	94.5	108.2	110.6	114.4	119.1	112.5	132.7
2019-20	107.8	110.1	106.5	100.2	92.0	86.4	99.5	112.7	120.9	124.3	123.3	131.0
2020-21	78.7	87.5	85.4									

* The figures for April, May and June 2020 are provisional



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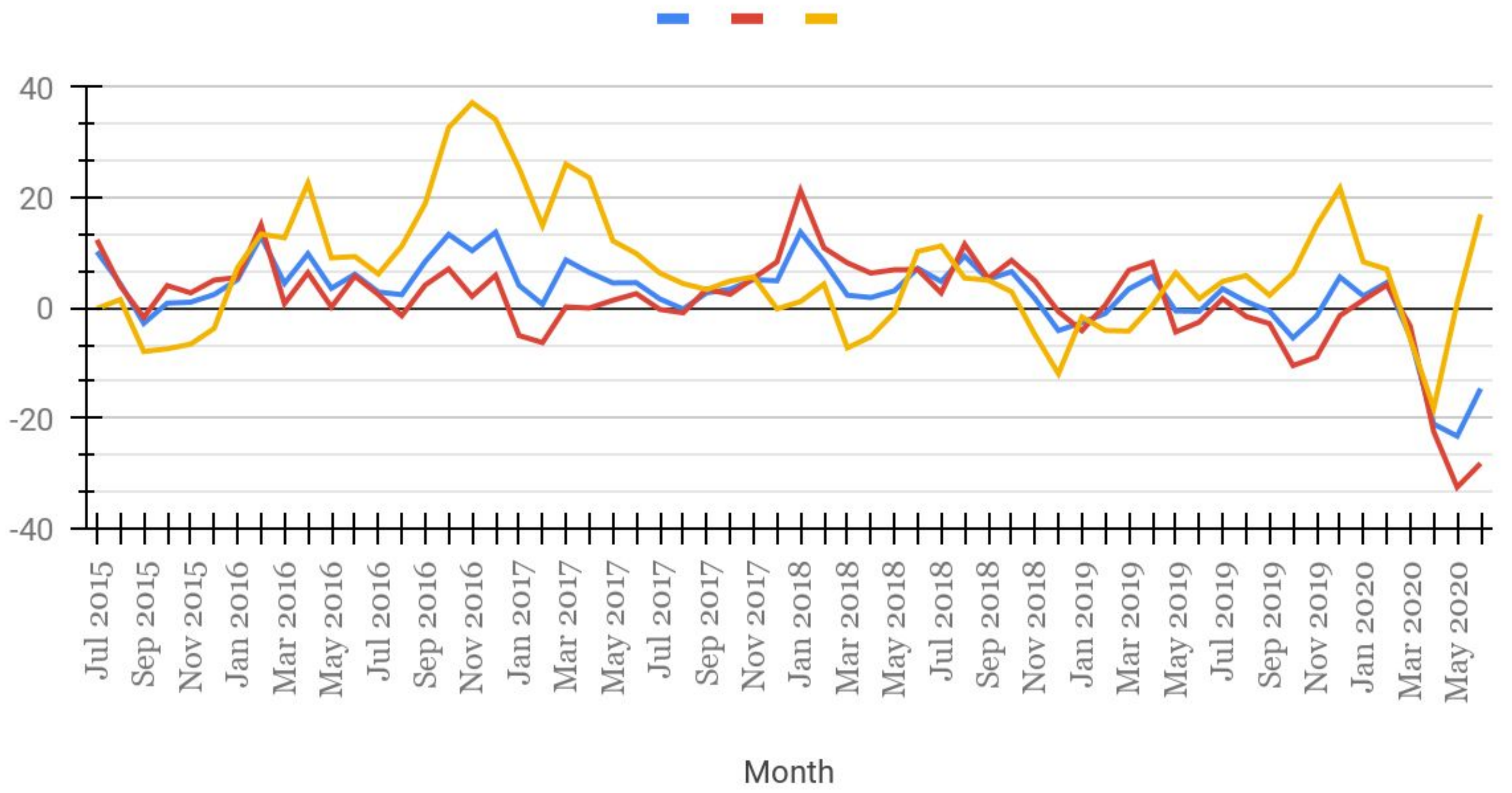
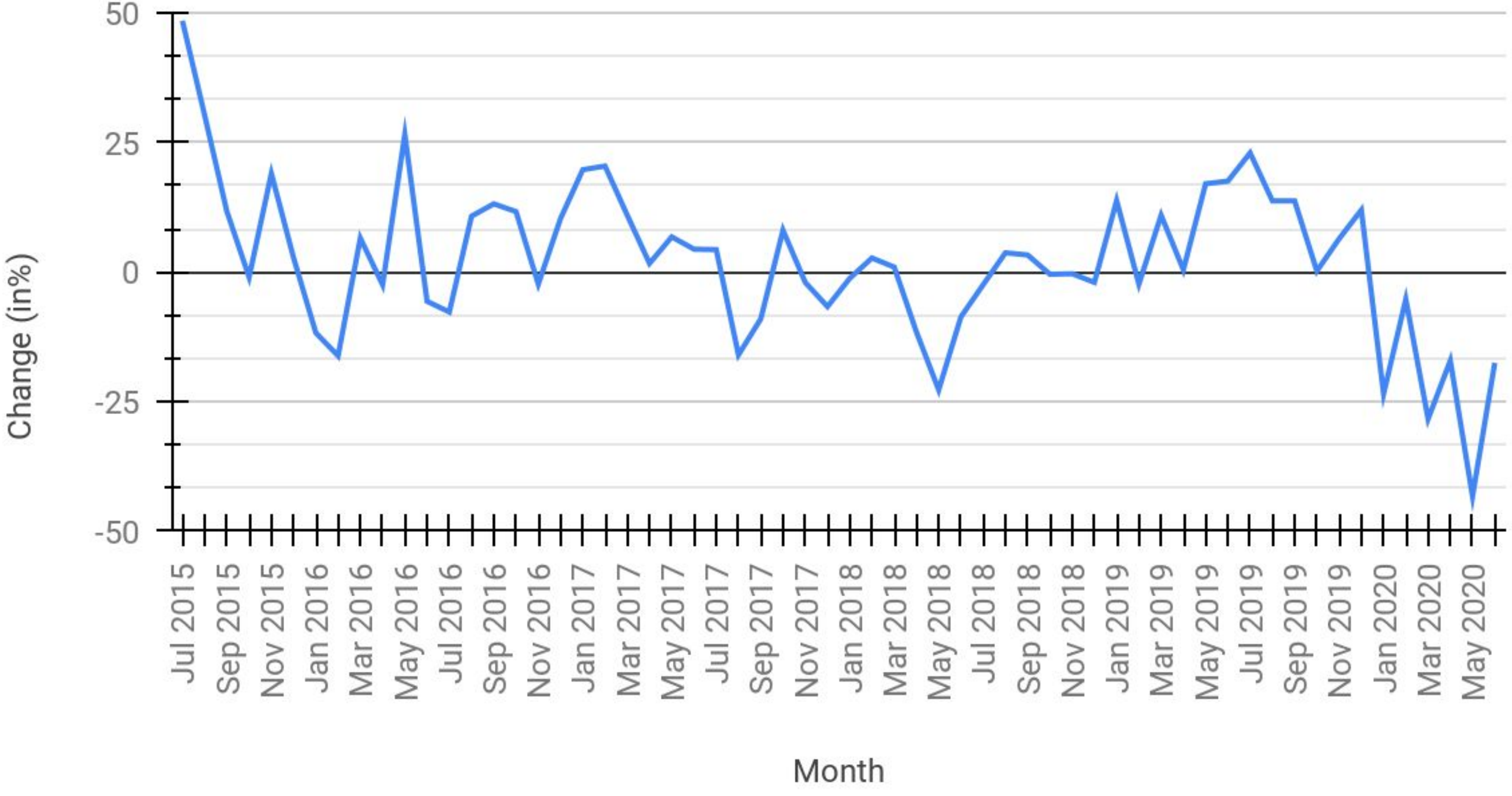
Loaded

Total Cargo, Unloaded and Loaded



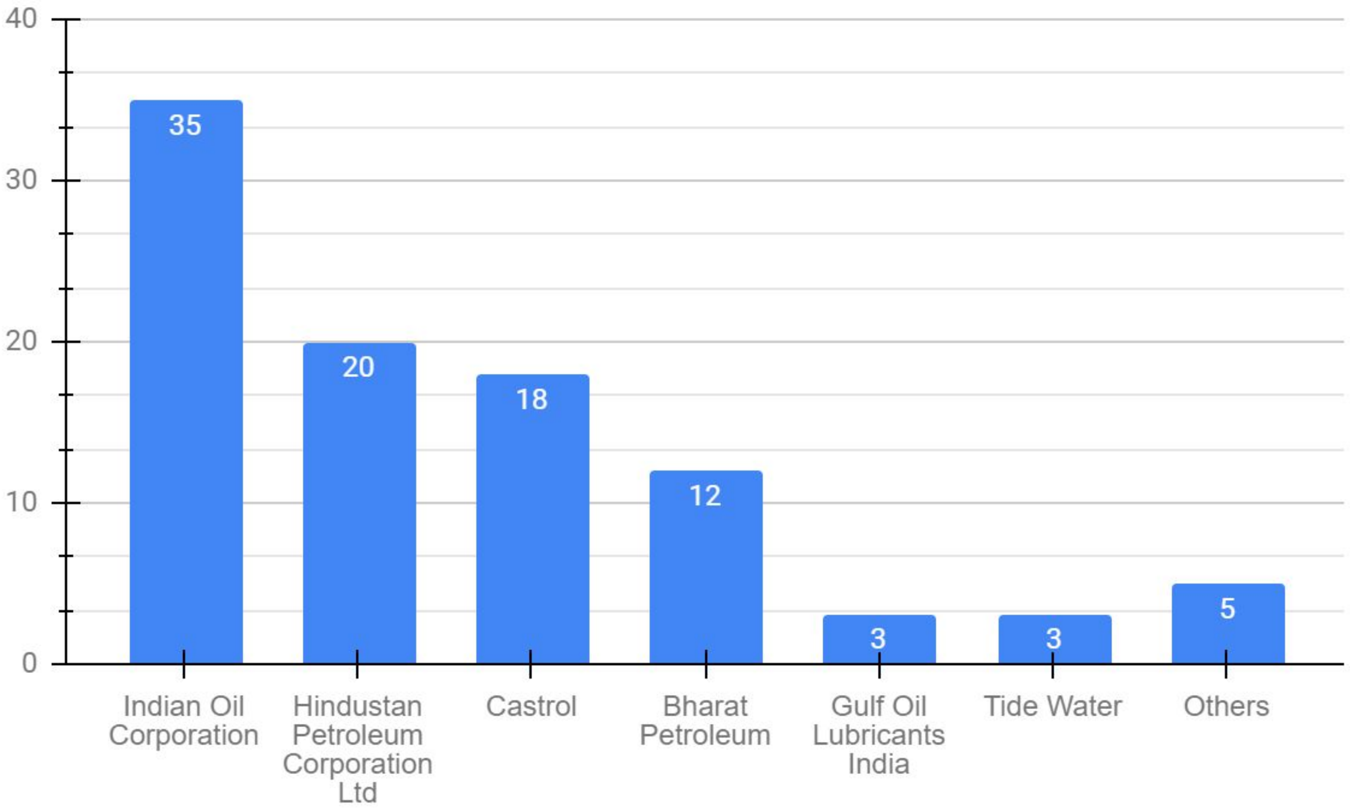
Transhipment



Porter’s Five Forces

Parameter	Description	Effect on the industry
Bargaining Power of Customers	Do customers have alternatives? How easy is it to switch?	Medium
Bargaining Power of Suppliers	Number of Suppliers? Availability of substitutes? Switching Costs?	Low
Threat of New Entrants	Barriers to Entry? Economies of Scale? Brand Identity and Distribution Network?	High
Threat of Substitute	Alternatives to the Industry?	Very Low
Existing Rivalry amongst Competition	No. of competitors Industry growth prospects Fixed Costs	High

Bargaining Power of Customers



Porter’s Five Forces

Bargaining Power of Customers: The lubricant market is dominated by 6 major players followed by a small number of firms, hence there is choice to switch to separate companies with the addition of low/no switching costs. Lubricant however has no substitute in the numerous uses it has. Thus the bargaining power of customers is medium as they have a choice within the industry.

In the case of Castrol, the bargaining power of consumers has been increasing as indicative of an increase in the business’ debtor days from 31 days to 41 days respectively.

Bargaining Power of Suppliers

Supply Chain (Brent)

Brent crude price is the international benchmark price used by the Organisation of Petroleum Exporting Countries (OPEC), while WTI crude price is a benchmark for US oil prices.

Since India imports primarily from OPEC countries, Brent is the benchmark for oil prices in India. Most of the oil produced in Europe, Africa and the Middle East is priced according to the cost of Brent crude.

Brent is the reference for about two-thirds of the oil traded around the world and hence it is slightly more sensitive to geopolitical tensions

Threat of New Entrants

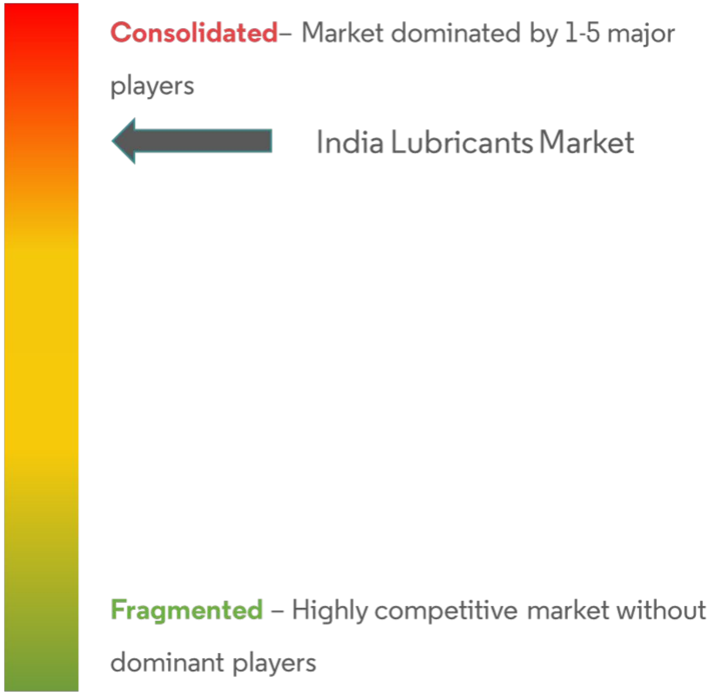
Lubricants are manufactured by blending base oils with additives. This blending involves highly advanced formulations as per the specific purpose the lubricant serves, and needs to be in line with the OEM specifications and industry norms. India is a net base oil deficit market leading to large scale import of base oil and additives. This exposes the lubricants business to fluctuations in foreign exchange rates.

Threat of Substitute

Lubricants play a major role in reducing friction generated by metal to metal contact. They also help in reducing noise and heat generation of metal parts - such as engines in automotive industry and cutting or honing parts in industrial application. There are no alternatives to synthetic lubricants as they are tailored as per industry specifications and no other substitutes are available.

Existing Rivalry amongst Competition

India Lubricants Market Concentration



Source: Mordor Intelligence

Growth Drivers

- Marine Lubricants

Growth in seaborne trade in the country along with increasing tourism activities with cursing and recreational sports will drive the growth of marine lubricants in the market. Furthermore, the development in the offshore drilling activities to meet increased demand and requirement for crude and petroleum-based products from chemical and refineries industry will support the growth of marine lubricants in the market.

- Demand from the Growing Wind Energy Sector

The installation of wind turbines in the country is increasing continuously each year. Gear oils are used for the lubrication of the gear motor, gearbox, and other components. The processes of power generation with wind turbines are stringent and involves load weights, corrosion and oxidation, high temperature, and bearing wear. The enhanced properties of gear oils are required to improve the efficiency of the wind turbine; hence there is an increasing demand for synthetic gear oils in wind turbines. Power generation from wind energy is rising at a swift speed that is also demanding for installation of wind turbines. Wind turbines are fueling the demand for gear oils that are driving the Indian industrial lubricants market.

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Opportunities

- BS VI compliance: The Company is poised to take advantage of further enhanced technologies becoming the first Company in the industry to have BS VI compliant products across all categories of automotive lubricants.
- Adjacencies: The Company is exploring different business models through adjacent businesses, moving beyond lubricants. It announced a strategic collaboration with 3M India to introduce a range of quality vehicle care products to be made available in the automotive after-market.
- Access to new channels: The partnership between BP and Reliance Industries in India for their new fuels and mobility joint venture gives the Company an opportunity to market its lubricants across the venture’s retailing network which is expected to be scaled up to 5,500 fueling stations in the next five years

Opportunities

- Castrol launched EV fluids globally (China and Europe). In 1QCY20, it signed agreements with MG Motors and Tata Motors for supply of EV fluids.
- BS6 lubricants sell at a premium since oil drain intervals are expected to rise in the commercial segment for BSVI engines
- Personal Mobility Segment- Indian economy revival would result in PCMO car sales. This would further lead to new/net sales volumes for the company. CSTRL has guided that it would continue to focus and invest in Personal Mobility (investments have resulted in 7% CAGR over the last decade)

(GST cut likely)

Threats

Economic uncertainty: Based on the current and future market environment estimates, the base oil and forex trends are expected to continue to be volatile.

Competitive activity: Competition in the lubricants market is intense and competitive activity is likely to remain high in the foreseeable future. There is also a trend of OEMs introducing lubricants under their own brand name, further impacting the competitive landscape

Quantitative Analysis

Revenue Breakdown and Analysis

Revenue Analysis and Stability Check (fig in cr)										
2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2,695.05	3,416.88	3,439.23	3,605.38	3,677.50	3,918.62	3,791.42	3,875.96	3,851.56	3,904.55	3,876.82
N/A	26.70%	0.65%	4.83%	2%	6.55%	-3.20%	2.22%	-0.62%	1.37%	-0.71%
10yr Sales CAGR	3.70%									

- The business' 10 yr sales CAGR may be misleading due to the fact that the last major increment in revenue took place in the year 2009. However, since then revenue has been increasing albeit at a really slow pace coupled with numerous years (i.e- 2015, 2017 and 2019) which saw a decline in gross revenue from operations altogether.

- In 2015, revenues saw a decline mainly due to the drop in volumes in the commercial vehicle segment.

- In 2017, net revenues saw an increase ~6% however gross revenues saw a reduction due to increased excise duty.

- In 2019, both gross and net revenue saw a decline due to the slowdown of The automobile industry, which contracted by ~14%

Revenue Breakdown and Analysis

In the most recent management discussion and analysis, the management stated that the auto industry’s slowdown, along with a reduction in investment driven by weak job creation and increased financial stress in rural households has led to a tough business environment. Coupled with the COVID-19 lockdown that halted production and has lead to limited demand for the company’s products.

This can be observed in the company’s financial results for its’ first two quarters for FY20.

In Q1FY20 (Jan - Mar): revenues saw a ~47% decline, to Rs. 688cr from Rs. 1011.8cr

In Q2FY20 (April - June): revenues saw a ~40% decline, to Rs. 490.6cr from Rs. 688cr

Thus, it can be concluded that this business is heavily dependent on not only macroeconomic factors, but the cyclical auto industry too.

Earnings Trend

Earnings Growth and Stability Check				
Year	2016	2017	2018	2019
EPS	6.78	6.99	7.16	8.36
EPS-GR	N/A	3.09%	2.43%	16.75%
4 yr EPS CAGR	5.37%			

- Due to Castrol changing it's accounting standards from IGAAP to IND AS in the year 2017. Only the past 4 years of EPS data is comparable with each other.
- Here, it can be witnessed that the business has consistently seen an uptick of earnings for the past 4 years, at a CAGR of 5.37%
- Thus it can be concluded that Castrol has an EPS growth rate akin to that of a slow grower.
- Due to the absence of debt or high fixed costs in the costing structure, EPS growth is organic and is usually a resultant of growing sales and/or cost optimization.

Income Statement Analysis

» Statement of Profit and Loss for the year ended December 31, 2019

Particulars	Note No.	For the year ended December 31, 2019 Rupees in Crore	For the year ended December 31, 2018 Rupees in Crore
Income			
Revenue from operations	15	**3,876.82**	3,904.55
Other income	16	**64.77**	84.31
Total Income		**3,941.59**	**3,988.86**
Expenses			
Cost of raw and packing materials consumed	17.1	**1,488.27**	1,757.77
Purchase of traded goods	17.2	**183.65**	213.34
(Increase) / decrease in inventories of finished goods / traded goods	17.3	**75.73**	(64.55)
Employee benefits expense	18	**213.08**	203.40
Finance costs	19	**1.19**	1.09
Depreciation and amortisation expense	20	**69.74**	55.57
Other expenses	21	**763.02**	723.82
Total Expenses		**2,794.68**	**2,890.44**
Profit Before Tax		**1,146.91**	**1,098.42**
Tax expenses			
Current tax [net of reversal of earlier years - Rs. 19.40 Crore (December 31, 2018 : Rs. 2.02 Crore)]		**323.33**	387.58
Deferred tax	6	**(3.79)**	2.48
Total tax expenses		**319.54**	**390.06**
Profit after tax		**827.37**	**708.36**

- Despite the fall in revenues ~1.1%, the overall expenses of the business fell by ~3.31% this includes the reduction of expenditure in raw materials and purchase of traded goods

- There was a notable deduction in tax expenses due to reduction in current tax and decrease in deferred tax.

- These factors combined have led to an increase in PAT by ~16.8%

Balance Sheet Analysis

Particulars	Note No.	As at December 31, 2019 Rupees in Crore	As at December 31, 2018 Rupees in Crore
Assets			
Non-current assets			
Property, plant and equipment	3	**197.37**	184.40
Capital work-in-progress	3	**27.33**	35.04
Other intangible assets	3	**2.33**	1.64
Financial assets			
Loans receivable	4.1	**8.97**	9.24
Other financial assets	4.2	**-**	0.10
Income tax assets (net)	5	**30.09**	37.97
Deferred tax assets (net)	6	**58.50**	53.27
Other non-current assets	7	**68.73**	58.48
Total Non-current assets		**393.32**	**380.14**

- In order to fully understand the effects of the COVID pandemic we'll be looking at a part of Castrol's balance as at December 2019. The business operates on a very small amount of fixed assets relative to the amount it generates with per unit of capital employed. This asset light structure is primarily what allows Castrol to enjoy it's high ROCE % and ROE %
- The largest component under Non-Current Assets, PP&E has increased by ~7.03%, in more recent statements (Q2FY20) however, the business has converted some of it's PP&E into right of use assets and seen a reduction in PP&E by ~11% no sale was undertaken as there is no reflection of such in the cash flow statement for that date. In addition to this the management has stated that it's main focus is to optimize costs and conserve cash.

Balance Sheet Analysis

Signs of Business Deterioration?

Before the COVID pandemic seized the world, there were little signs of business deterioration. As of 31st December 2019:

Inventories: Had fallen by a whopping 33.72%, while revenue fell by merely 1.1% which shows that the management was efficient in it’s estimation of inventory requirements.

Trade receivables: had risen by 23.02%, which is massive when taken in consideration with the revenue degrowth for the year. **This is a visible sign of business deterioration as it indicates that the bargaining power of customers has risen.**

Cash and Cash Equivalents: Cash balances improved with a 27.17% increase.

Debt: The business is virtually debt free, i.e - it holds no long term debt.

Balance Sheet Analysis

Signs of Business Deterioration?

Post COVID however, the situation is very different, the Balance Sheet as at 30th June 2020 shows that:

Inventories: have increased by ~10.6% while revenues have fallen to Rs. ~Rs.496cr from ~Rs.1011cr which is a massive 50% fall in revenue from the December quarter to June Quarter. **This is a sign of business deterioration.**

Trade receivables: have declined by 53%, primarily due to the business' reduced scale of operations as indicative of its' significant degrowth in revenues for the first two quarters of this year.

Cash and Cash Equivalents: Cash and Cash equivalents have increased by ~17% which is in line with the management aiming to conserve cash.

Debt: Under the non-current liabilities of the business, there has been an addition of ~21.1 cr in total, attributed to an increase in other financial liabilities and other liabilities.

It should be noted that current liabilities have largely remained the same for both periods.
Rs. 840.4cr as at December 2019 and Rs. 841cr as at December 2020. Hence,
The liquidity position has degraded, however the business still enjoys strong liquidity.

Balance Sheet Analysis

Long Term Sources (LTS):
- Equity Share Capital = Rs. 494.6cr
- Other Equity = Rs. 770.2cr
- Other Financial Liabilities = Rs. 11.8cr
- Other Liabilities = Rs. 9.3cr
- Provisions = 21.4cr

Total = 1,307.3cr

Short Term Sources (STS):
- Trade Payables = Rs. 312.2 cr
- Other Financial Liabilities = Rs. 348.3cr
- Other Liabilities = Rs. 140.2cr
- Provisions = Rs. 31.1cr
- Current Tax Liabilities = Rs. 9.7cr

Total = Rs. 841.5 cr

Long Term Uses (LTU):
- Fixed Assets = Rs. 401.3cr

Short Term Uses (STU):
- Current Assets = Rs. 1,747.5cr

Balance Sheet Analysis

LTS > LTU, as a result some long term sources of funds can be used to fund short term uses. In addition to this, we can conclude that the management of the business follows the first principle of financial management, whereby there are fund inflows before fund outflow (as there are returns that are generated using long term sources of funds, which by definition don’t need to be paid back within the course of the financial year).

Cash Flow Statement Analysis

Cash Flow Statement Analysis (Fig in Cr)										
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Net Cash Flow Generated From Operations	514.76	352.38	466.85	396.43	547.6	740.01	663.31	609.26	549.48	879.49
Net Cash Flow Used In/Generated From Investing Activities	-10.83	11.05	0.78	29.88	-13.74	2.26	29.29	151.37	66.12	-448.26
Net Cash Flow Used In/Generated From Financing Activities	-420.51	-432.77	-432.87	-406.68	-696.63	-477.22	-568.03	-656.74	-567.42	-627.72

Cash Flow Statement Analysis

- Cash Flow from Operating Activities have largely been increasing over the past 10 years, however there is an element of volatility to the business' operating cash flows. It should be noted that the business has had positive CFOs consistently over the past 10 years.

- Over the past 10 years, Cash was generated from Investment Activities barring the years, 2010, 2014 and 2019. 2019 saw the largest dip due to a large placement of bank deposits and purchase of PP&E.

- Cash Flow from Financing Activities have largely been negative throughout, largely due to the payment of dividends and minor interest payments.

Free Cash Flow Analysis

Free Cash Flow Analysis (in Cr)					
Year	2015	2016	2017	2018	2019
FCF	762.01	661.58	614.84	501.43	866.52

- The business has had declining FCFs for 4 out of the past 5 years.
- The 72.8% increase in free cash flows is primarily attributed to - a decrease in inventories, a higher PBT due to cost optimization.

Financial Risk Management

Types of exposure :

- Liquidity Risk
- Market Risk
- Credit risk

Liquidity Risk

The principal sources of liquidity are cash and cash equivalents and the cash flow that is generated from operations.

The company has no outstanding bank borrowings. Working capital is sufficient to meet its current requirements. Accordingly, no liquidity risk is perceived.

Market Risk

Market Risk

Forex Risk

Commodity Price Risk

Forex Exposure–Primary Risk

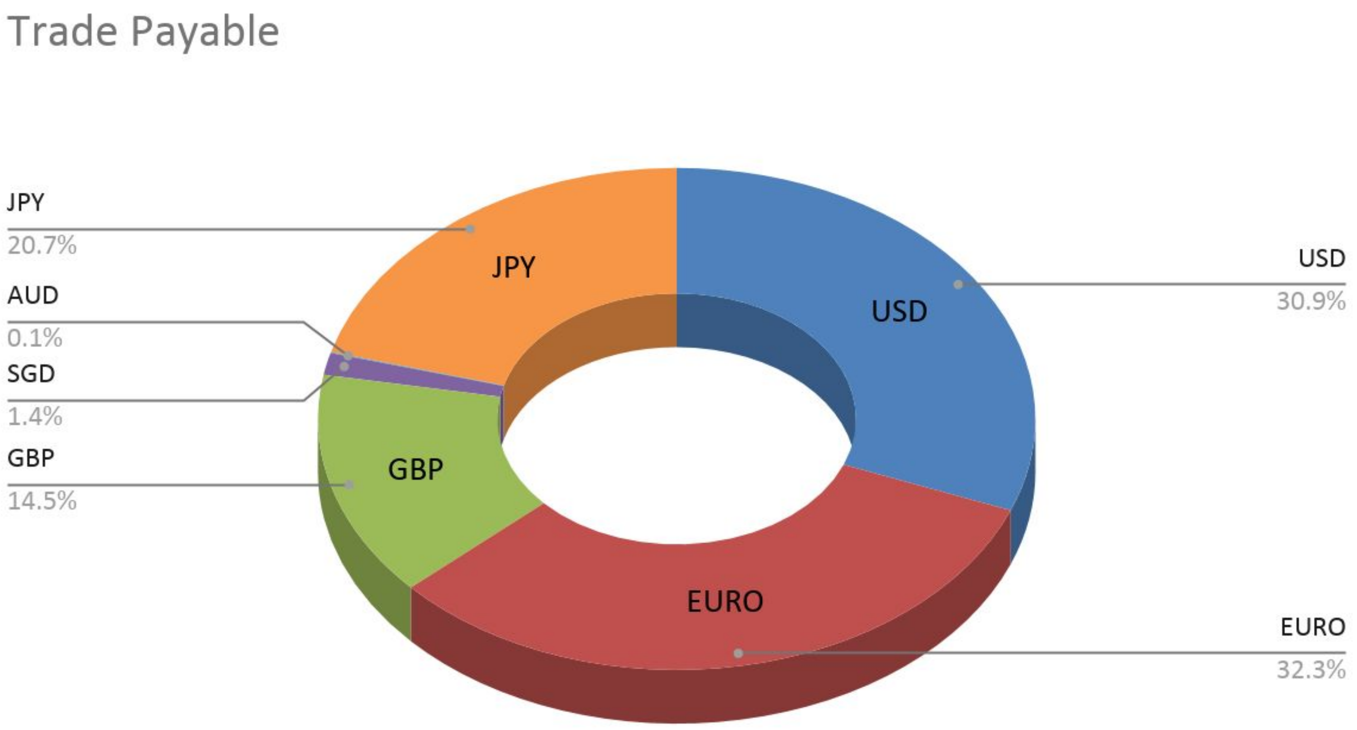
Using forward contracts to hedge

What is the risk?- future value of cash flows change due to market movements

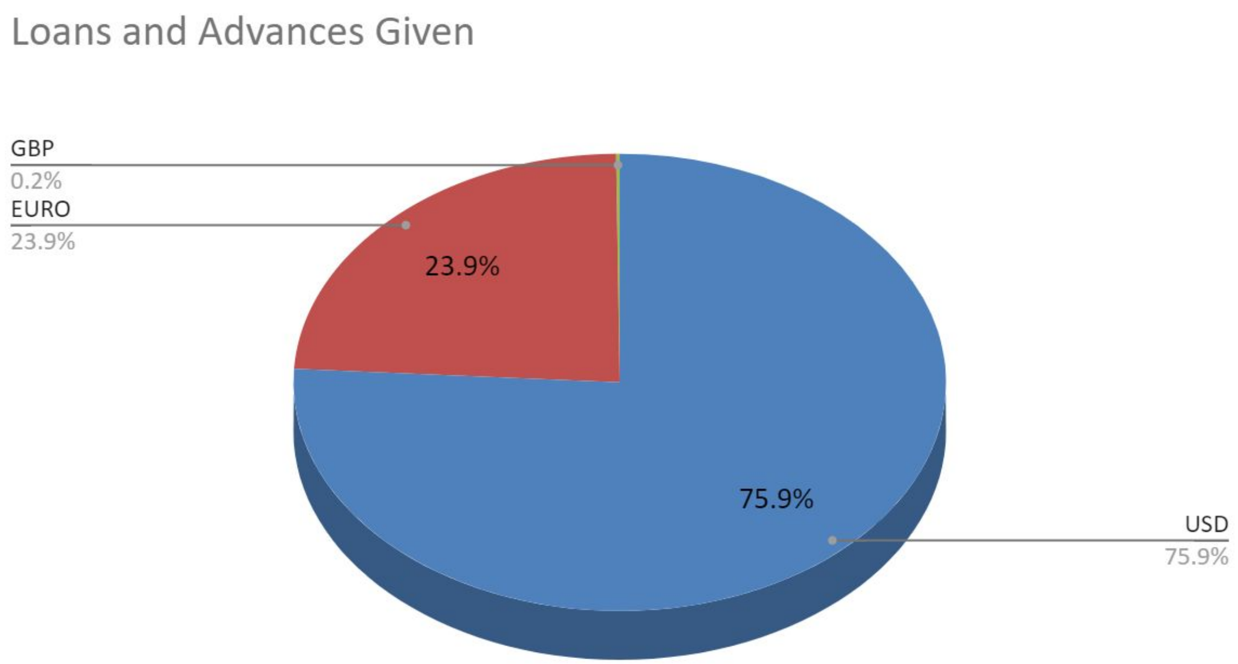
Why the risk?-material costs are denominated in foreign currency

hedged approximately ~ 80-85% of its expected foreign currency purchases for 1 to 3 months at 31/12/19

Unhedged exposure



Unhedged exposure



Commodity Risk

1% decrease in commodity rates would have led to approximately an additional Rs. 0.54 Crore (December 31, 2018 – Rs.1.08 Crore) gain in the statement of profit and loss. 1% increase in commodity rates would have led to an equal but opposite effect.

The exposure to market risk with respect to commodity prices primarily arises from because they purchase base oil. This is a commodity product whose prices can fluctuate sharply over short periods of time. The prices of base oil generally fluctuate in line with commodity cycles. There are no direct derivatives available for base oil like the derivatives for crude oil.

Credit Risk

The Company is exposed to credit risk from its operating activities (primarily trade receivables), deposits with banks and foreign exchange transactions.

However since they are of the opinion that ‘best practices’ are adopted with regards to their credit policy, they do not perceive a credit risk and thus have also not made a provision

Ratio Analysis & Comparables

Ratio Analysis

Profitability Ratios					
Year	2015	2016	2017	2018	2019
OPM %	28.85%	31.07%	29.88%	28.15%	29.61%
CAGR			0.50%		
NPM %	18.65%	20.02%	19.30%	18.14%	21.34%
CAGR			2.70%		

- The Operating Profit Margins of the business have increased marginally, despite seeing a few minor dips in between. The business has largely enjoyed margin stability despite a challenging business environment primarily due to cost optimization.

Ratio Analysis

Managerial Efficiency Ratios					
Year	2015	2016	2017	2018	2019
ROCE %	104.18%	110.67%	66.77%	93.05%	82.69%
ROE %	106.88%	113.28%	67.81%	60.76%	60.52%
ROA %	37.02%	35.76%	34.99%	33.62%	37.12%

- The business has enjoyed extremely high ROCE % and ROE % due to the asset light nature of the business. This in turn allows the business to generate a large amount of income per unit of capital employed. The same case can be said about ROE %. There isn't a significant amount of divergence between the values due to the absence of long term debt.

- It should be noted that ROCE % and ROE% have been sharply decreasing over the past 5 years, that too at an alarming rate.

- ROA % have largely remained constant at a healthy 30 and upper 30% levels.

Ratio Analysis

Turnover Ratios And Debtor Days					
Year	2015	2016	2017	2018	2019
ITR	10.83	9.8	11.22	8.55	12.72
ATR (%)	198.48	178.58	181.3	185.33	173.94
Debtor Days	28.24	27.64	29.02	36.54	45.37

Inventory Turnover Ratios indicate a cyclical trend but it has largely been improving which is a positive sign

ATR has not witnessed a steep trend. It is largely constant. It decreased due to capital expansion.

Debtor days have been consistently increasing which is a sign of inefficiency. Provision for bad debts has increased as well. Which furthers the argument that the bargaining power of consumers is increasing.

Ratio Analysis

Liquidity Ratio					
Year	2015	2016	2017	2018	2019
Current Ratio	1.24	1.21	1.67	1.87	2.18
Quick Ratio	0.96	0.94	1.33	1.37	1.82

Over the past 5 years, the business has had a consistently increasing Current Ratio and Quick Ratio which implies that the business has had no form of liquidity issues and can comfortably meet all its' short term obligations.

Towards the more recent years, both Quick Ratio and Current Ratio are towards the higher side, which indicates the ability of the business to survive the recessionary situation of the industry.

Ratio Analysis

Solvency Ratio					
Year	2015	2016	2017	2018	2019
D/E	0	0	0	0	0

No solvency issues since they do not have any debt.

Valuation Ratios

Valuation Ratios	
P/E (current)	18.69
P/E (Historic)	25.075
PEG (current)	18.69 / 16.7 = 1.1
PEG (Historic)	25.075/16.7 = 1.5
P/B ratio	8.9
FCF	866.52
FCF yield %	7.10%
Earnings Yield %	5.20%

- The business’ current P/E has been shrinking and is below it’s 4 year historic p/e.
- The PEG ratio signals that the business is fairly valued however upon looking at historic p/e even with the increased earnings growth rate, the historic PEG is 1.5, which indicates that the stock is selling at a premium.
- The stock is selling at 8 times it’s book value, which is unsurprising given to how high the business’ efficiency ratios are.
- The business has been experiencing dwindling fcfs for the past 4 years, up until Dec 2019.

Valuation Ratios

- The business' free cash flow yield at 7.10%, which is considered to be of high rank especially when looking at analysis from a dividend perspective.

- The earnings yield at 5.20%, beats out alternative investment avenues like fixed deposits which have interest rates ranging from 3.5% - 6.5% p.a, the earnings yield % could further increase due to shrinkage in the price to earnings ratio, however due to COVID-19s impact on demand for the business' products, the subsequent fall in revenues and the earnings dip may also cause a fall in earnings yield which renders the business unattractive from a valuations perspective. This is especially worrying as the business is already selling at a valuation akin to that of a fast grower while its' characteristics enable it to resemble that of a slow grower.

Dividend Ratios

Dividend Ratios	
Dividend Payout Ratio (CP) %	60.64%
Dividend Payout Ratio (NP) %	65.75%
Dividend Yield %	4.47%

- The company boasts a high dividend yield akin to that of a slow grower. However, it should be noted that dividend payouts are extremely high, both out of net profits and from the perspective of free cash flow.

- This is a negative signal, when we take into account that the business' earnings power is in question primarily due to the business' dependence on cyclical industries and macroeconomic factors.

Historic P/E ratios

Historic P/E Calculation (Using Closing prices for each month)															
Financial Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg. Pric	EPS	P/E
2016	224.35	183.7	187.08	198.15	187.48	189.5	221.2	223.53	237.48	228.8	203.83	190.33	206.28	6.78	30.4
2017	202.63	203.5	216.2	219	212.08	202.35	200.33	194.4	178.3	199.95	199.85	193.2	201.81	6.99	28.87
2018	185.4	201.95	204.9	194.85	170.9	163.7	174.35	158.8	142.85	148.7	151	151.25	170.72	7.16	23.84
2019	158.65	154.65	166.4	152.6	147.2	132.55	124.65	122.85	136.05	152.15	140.75	129.3	143.15	8.36	17.12
													Historic P/E		25.0575

- Despite, the core business relying heavily on macroeconomic factors and it serving as an ancillary industry to the highly cyclical auto industry the business has been relatively stable, with a shrinking price to earnings ratio! Castrol has enjoyed a consistency in earnings growth despite it being marginal. be attributed to the p/e re-rating effect which the business has been enjoying due to it's consistent stellar earnings growth in prior years.

- It should be noted however, that the business is selling below its' historic p/e and its' earnings growth has been above it's 5 year average as of December 2019.

Comparables

	CMP	Market Cap.(crores)	TEV (crores)	Revenue	EBITDA	Eanings	EV/sales	EV/EBITDA	P/E
Gulf Oil	680	3412	3306	1718.93	342.9	214.46	1.88	9.64	20.05
Tide Water Oil	4747.9	1773	892.78	1453.2	193.13	122.06	1.22	9.18	13.22
Savita Oil Tech	760.4	1031	965	2412.5	181.05	104.9	0.4	5.33	13.75
PanamaPetrochem	49.45	271	281	878.13	39.3	24.89	0.32	7.15	12.04
Average							1.494	8.67	15.55
Median							1.22	9.18	13.75
Castrol	123.6	12260	11096	3040	919.3	767.57	3.65	12.07	18.71

According to Comparable Company Analysis, Castrol is likely overvalued due to higher P/E, EV/sales, EV/EBITDA than the average P/E, EV/sales, EV/EBITDA of the comparables.

Summary of Investment Thesis

- Castrol India Ltd. is a **fundamentally strong and stable enterprise**, as indicative of it's high ROCEs and ROEs and strong balance sheet which boasts a debt free position.
- **It's intrinsic characteristics are akin to that of a slow grower**, i.e businesses that grow slightly faster/at the same rate of GDP and offer a **generous dividend yield**.
- Despite a largely consistent earnings track record, it should be noted that Castrol India Ltd. is heavily dependent on macroeconomic factors and the cyclical automobile industry, for this reason the business is **not recession resistant.** It's sharp fall in revenues and earnings of the first 2 quarters of the financial year highlight this point.
- From the points above, we can see that Castrol India Ltd. offers a generous dividend, however due to it's **high payout ratios, there is little to no safety of the business' dividends.**
- As observed in the most recent financial year (2019), the business was on the cusp of a turnaround, i.e - from the status of a slow grower to that of a stalwart (businesses that observe a 10-12% growth in earnings) however it is unlikely the business will be able to go through such a transition due to weak demand and the challenging business environment it's currently in, though **cost cutting may persist.**
- The business is priced akin to that of a fast grower as observed by it's **high p/e**, although it should be noted that the **p/e is witnessing a shrinkage**.
- Thus due to the expensive valuation and lack of safety of dividend coupled with a challenging business environment and lacklustre performance ahead, we assign Castrol India Ltd. a **HOLD** rating.