Stock idea

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A Bajaj Capital Venture

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BUY

CMP *(05.12.08)*	:	**Rs. 311.25**
Target	:	**Rs. 448.00**
Upside Potential	:	**44%**
Horizon	:	**12 mths**

As on 5th Dec 2008

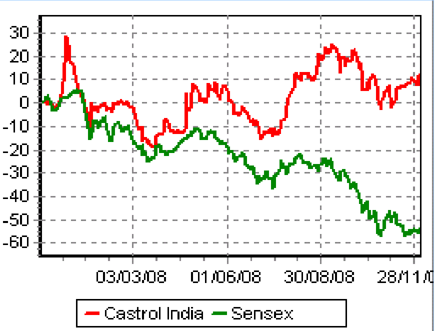
Price Performance

	CMP	(1M)	(3M)	(12M)
S&P CNX Nifty	2714.4	3142.1	4447.8	5858.4
Castrol (Rs.)	311.3	299.0	347.4	287.6

Absolute Returns (%)

	(1M)	(3M)	(12M)
Castrol	4.1	-10.4	8.2
S&P CNX Nifty	-13.6	-39.0	-53.7

Castrol India Ltd. vs. BSE Sensex



Castrol India Limited

Castrol India Limited is a public limited company with 70.92% of the equity held by Castrol Limited UK (part of BP Group). From a minor oil company, with a share of about 6% in 1991, the company has grown to become the second largest lubricant company in India with a market share of around 22%. 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 Silvassa. It reaches its consumers through a distribution network of 270 distributors, servicing over 70,000 retail outlets. Castrol India Limited (CIL) is the second largest player in Indian lubricant segment. It makes automotive lubricants under two brands viz. Castrol and BP. The company has leadership position in most of the sub-segments in which it operates including passenger car engine oils, premium 2 stroke and 4 stroke oils and multi-grade diesel engine oils. 85% of Castrol's sales volume comes from the automobile segment and the rest 15% comes from the industrial segment. In the auto segment, more than 70% of the revenues come from diesel engine oils which are used by trucks, and the rest from the car and motorcycle segment. Castrol has weathered intense competition that came about in the lubricant business after the liberalization in 1990s and has continued to prosper. Despite rising price of crude oil and hence its raw materials, Castrol has reported strong operational performance. With continuous focus on cost efficiency, customer services and up gradation of its product portfolio, Castrol has outperformed all players in its space.

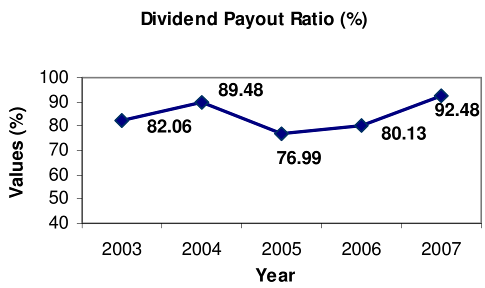
Despite having limited scope for growth in the near future, the stock remains an excellent defensive bet in the current scenario on the back of robust cash flows, strong cash reserves, consistently high dividend payouts (in the range of 80-90%), attractive dividend yields (in the range of 4-5%) and a comparatively low PE ratio as compared to its high dividend paying FMCG peers. Moreover, the company's business volume is driven mainly by repeat demand along with new demand, which is likely to sustain in the near term.

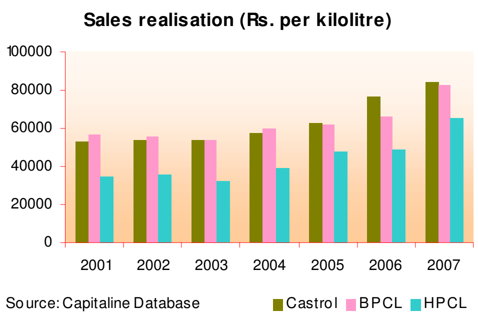
Key Investment Arguments

- **Bike Zone:** Castrol had launched its flagship Castrol BikeZone outlets, an automated bike cleaning place. There are around 100 Bike Zone outlets in the country. However going forward the company is likely to reduce the pace of opening Bike Zone outlets due to high real estate prices and given the current economic situation.
- **Attractive Dividend Payout –** Due to lower capital expenditure and working capital requirement on the back of efficient working capital management, Castrol has given a high average dividend payout of approx. 84% in the past 5

Brief Profile

Industry		Lubricants
House		MNC Associate
CMP – 05.12.08 (Rs)		311.3
Mkt. Cap (Rs cr)		3848.3
Face Value (Rs.)		10.0
52 week (Rs)	**High**	**52 week (Rs)**
	Low	
Book value (Rs)		34.8
P/BV (ttm)		8.9
P/E Ratio (ttm)		14.3
Last Dividend (%)		(Interim Q2CY08) 60.0
Avg. daily volume		25994





Source: Capitaline Database

years. In the wake of lesser capital expenditure requirement from the company in the near future, it is most likely that the past trend of high dividend payouts shall be continued in the near future. The dividend yield on the stock, based on last year's dividend of Rs. 14 per share, thus comes at an attractive 4.45% at the current market price. The stock thus presents an excellent defensive investment option in the current scenario.

- **Demand likely to remain robust:** Lubricants are consumables and their demand is directly related to the number of vehicles on the road and the level of manufacturing activity in the economy. In the past five years, the number of vehicles on Indian roads has nearly tripled, while manufacturing capacity across sectors has jumped manifold. This will ensure that the company will see a steady growth in revenues and profits for the next few years.
- **Out performer:** The stock has been an out-performer in the current downturn, appreciating by 9.0% in the past 12 months as against a negative return of 52.4% from the S&P CNX Nifty during the same period.
- **Strong quarterly performance in Sept 08 quarter:** Revenues of the company grew by 29% and net profit by 10% in Q3CY08 due to increase in product prices which were done twice during the third quarter. However the profitability of the company remained under pressure on the back of high base oil prices which increased by an unprecedented 47%, despite falling crude oil prices. It is expected that base oil price will fall eventually in the coming quarters in line with falling oil prices. High input margin of the company by 348 and 187 basis points respectively in Q3CY08 vis-à-vis the same quarter of the previous year.
- **Enjoy Premium Pricing Power:** Castrol has been able to hold on to its market share in spite of stiff competition from PSU peers. Castrol has already seized the opportunity on both pricing front, with premium pricing, and on product innovation front. It has hiked the prices thrice in CY08 and 9 times in last 24 months due to sharp movement in crude oil prices. The higher product prices were well accepted by the market due to superior product quality and premium brand positioning to a segment which is less price sensitive and more value conscious.
- **Demand Inelastic:** Lubricant demand in motorcycles, passenger cars and B2C (business to consumer) industrial category is price-inelastic due to its low running cost. A change in price doesn't necessarily bring about a change in volume consumed and this allows for an increase in price without much of an effect on volume.
- **Creating value:** The global acquisition of Castrol by British Petroleum (BP) has brought a change in focus of the company with increase in focus on developing competitiveness through quality assurance and business process re-engineering. This is likely to further boost the premium pricing ability of the company. Growth in sales value for Castrol is being driven by improvement in the sales mix, with better growth in high value bike oil and passenger car oils.

Shareholding Pattern

	30-Sep-08 (%)
Promoters	**71.0**
Indian	0.0
Foreign	71.0
Non Promoters	**29.0**
FIIs/FDI	3.2
FI/MF	10.3
Public	15.5
Total	**100.0**

Analyst Window

House	View	Price Target
ABN Amro	Buy	360
JP Morgan	Buy	N/A

Summary

View	No. of Analysts	% of total
Buy	2	100%
Sell	0	0%
Hold	0	0%
Total	**2**	**100%**

- **Aggressive Pricing:** Castrol has been more aggressive and proactive on the pricing front then ever before. It increases prices without waiting much for a pressure to come from increase in raw material price and this has paid off looking at the steady margins of the company despite substantial increase and volatility in base oil prices over the previous few quarters.
- **Competitive edge:** Castrol's competitors are mainly state owned oil marketing companies which are facing subsidy pressure resulting in poor profitability. These companies are not aggressive in pricing and marketing their products which gives an edge to Castrol over its peers.
- **Valuations**: The recent pressure on profitability is expected to ease by Q1CY09 on the back of the recently carried out price hikes and a fall in base oil prices. The base oil price has been steady and any fall from the current levels would percolate to the bottom line. Continuous product innovation coupled with superior quality and strong brand recall is also likely to keep Castrol on its above average growth path. At a CMP of Rs. 311.25, Castrol is trading at a PE multiple of 14.3 based on EPS for the trailing twelve months ended 30th Sep 2008, Price to Book ratio of 8.9 on 2008 book-value and Price to Sales ratio of 1.8 based on sales for trailing twelve months ended 30th Sep 2008.

Key Concerns

- Base oil prices, a key input for lubricant manufacturing, are a function of crude oil prices. High volatility in crude oil prices results in volatile base oil prices. The same can have an adverse impact on the economics of lubricant manufacturing.
- Castrol has no plans to increase its existing capacity in the near future despite it running at more than 100% capacity utilization rates since 1997. Hence, volume growth is likely to remain limited in near future pending further capacity addition. Profit growth in the near future would thus be driven only by increased realizations. Moreover capacity additions, if they happen in near future, are likely to put a strain on the company's finances given the fact that retained earnings are low due to high dividend payouts.

Conclusion

On the basis of our research, we feel that this is a good stock to buy at the current market price of Rs. 311.25. If everything goes well, the price is likely to appreciate to Rs. 448.0, within 12 months, translating into a gain of about 44%.

Financials

(Rs. in crore)

	9M 200809	200712	200612	200512	200412	200312	200212	5 yr CAGR %
Share Capital	123.6	123.6	123.6	123.6	123.6	123.6	123.6	
Networth		430.2	417.7	390.1	360.1	348.1	325.8	
Revenues	**1669.8**	**1966.0**	**1802.5**	**1464.5**	**1347.7**	**1207.5**	**1175.1**	**10.8**
EBITDA	**359.7**	**364.3**	**254.2**	**232.5**	**222.9**	**221.0**	**250.9**	**7.7**
APAT	**215.2**	**218.5**	**142.8**	**144.9**	**128.7**	**134.9**	**156.6**	**6.9**
Operating Cash Flows		356.8	93.8	110.9	162.7	104.9	272.5	
Dividend %	60.0	140.0	90.0	82.5	82.5	82.5	165.0	
CEPS (Rs.)		16.8	12.7	12.3	11.2	11.2	11.9	7.3
EPS (Rs.)*	17.4	15.1	11.2	10.7	9.2	10.1	10.8	7.0
Debt-Equity Ratio		**0.01**	**0.01**	**0.01**	**0.01**	**0.01**	**0.04**	
Interest Coverage Ratio	**126.1**	**90.6**	**57.5**	**70.9**	**69.0**	**80.4**	**31.9**	
RoNW %		51.5	38.3	39.1	36.0	40.8	42.3	
EBITDA Margin %	**21.5**	**18.5**	**14.1**	**15.9**	**16.5**	**18.3**	**21.4**	
APAT Margin %	**12.9**	**11.1**	**7.9**	**9.9**	**9.5**	**11.2**	**13.3**	
Total Asset Turnover Ratio		4.7	4.3	3.7	3.6	3.4		
Fixed Asset Turnover Ratio		16.2	14.0	10.6	8.6	7.0		
Price/Sales	1.8							
PE Multiple	14.3							
P/BV Ratio	8.9							

* EPS for nine months ended 200809 is absolute and not annualized.

Information Sources

1. ISI Emerging Markets
2. Capitaline Plus

Disclosure of interest:

1. BCL and its affiliates have not received compensation from the company covered herein in the past twelve months for Issue Management, Capital Structure, Mergers & Acquisitions, Buyback of shares and other corporate advisory services.
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