

JANUARY 11, 2010

UPDATE

Coverage view: **Cautious**

Price (Rs): **596**

Target price (Rs): **625**

BSE-30: **17,540**

All is well. We believe the 6-7% price hike announced in January 2010 will help boost margins. Our new earnings estimates reflect (1) a 6-7% price hike and (2) moderately higher LOBS price. We maintain our ADD rating with a revised target price of Rs625 (Rs550 previously). We do not rule out further improvement in margins upon (1) lower-than-expected LOBS prices and (2) a strengthening of the Re. Key downside risks are (1) higher-than-expected LOBS prices and (2) slower-than-expected recovery in demand.

Company data and valuation summary

Castrol India (a)

Stock data		Forecasts/Valuations			
		2010	2011E	2012E	
52-week range (Rs) (high,low)	627-287	EPS (Rs)	33.2	40.4	41.2
Market Cap. (Rs bn)	73.7	EPS growth (%)	55.7	21.7	2.0
Shareholding pattern (%)		P/E (X)	18.0	14.8	14.5
Promoters	71.0	Sales (Rs bn)	23.5	25.4	26.5
FIs	5.2	Net profits (Rs bn)	4.1	5.0	5.1
MFs	2.6	EBITDA (Rs bn)	6.6	8.0	8.2
Price performance (%)		EV/EBITDA (X)	10.8	8.8	8.5
Absolute	1M 6.7 3M 6.2 12M 89.5	ROE (%)	85.8	88.3	74.0
Rel. to BSE-30	4.2 0.8 1.6	Div. Yield (%)	4.0	4.4	4.4

Price hike of 6-7% will boost margins; revising earnings, raising target price to Rs625

We believe a price hike of 6-7% announced in January 2010 (effective from mid-February 2010) will help boost margins for Castrol. We note that operating conditions have improved led by (1) recovery in demand as reflected in improving diesel sales, (2) stable base oil prices and (3) a stronger rupee. We have revised our earnings for CY2010E and CY2011E to Rs40.4 and Rs41.2 from Rs36.5 and Rs37.1 to reflect (1) a 6-7% price hike effected and (2) moderately higher LOBS prices. We maintain an ADD rating on the stock with a revised target price of Rs625 (Rs550 previously) based on 15X CY2010E earnings.

Stable LOBS prices and strengthening rupee will lead to margin expansion

We note that LOBS prices have been stable since early November 2009 and have declined moderately in recent weeks. We do not rule out further expansion in margins led by (1) lower LOBS prices and (2) a strengthening of the Re. We currently model LOBS prices at US\$875/ton (+US\$50/ton yoy) and exchange rate at Rs46/US\$ for CY2010E. We note that Castrol earnings have high sensitivity to changes in LOBS prices and exchange-rate assumption. A US\$25/ton decline in raw material costs will impact Castrol's EPS by 2.2% and a strengthening of the Re by Re1/US\$ would impact Castrol's EPS by 2.9% (see Exhibit 1).

4QCY09E results will be good

We expect Castrol to report strong results in 4QCY09E with net income of Rs 1.1 bn (+14.9% qoq and +134% yoy). We estimate sales volumes of 55,870 liters in 4QCY09 versus 46,000 liters in 4QCY08 and 50,700 liters in 3QCY09. The yoy jump in volumes of 21% reflects the low base effect. The qoq jump in volumes of 10.2% reflects the seasonality impact as 2Q and 4Q are the best quarters for Castrol.

QUICK NUMBERS

- Price hike of 6-7% announced in January 2010
- A US\$25/ton decline in raw material costs would impact EPS by 2.2%

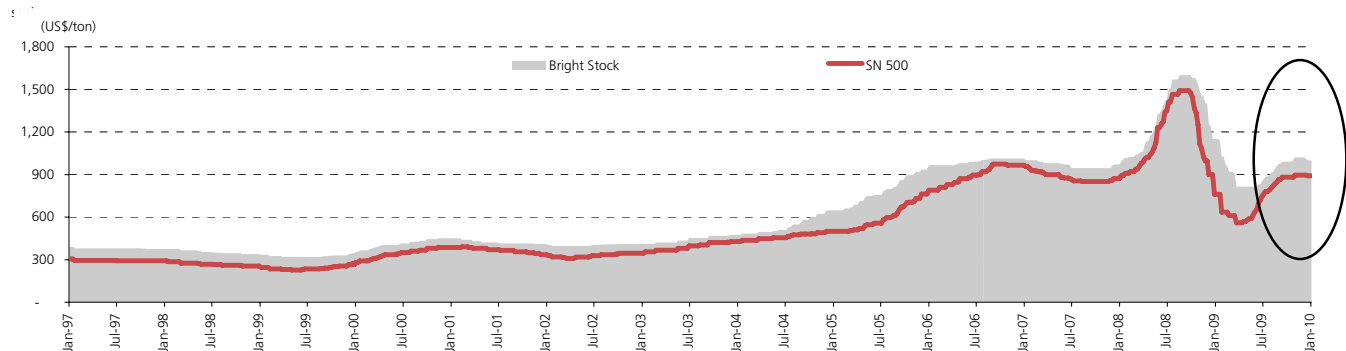
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Base oil price, Singapore FOB (US\$/ton)



Bright Stock, December calendar year-ends (US\$/ton)												
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1Q	328	371	444	400	414	484	660	965	996	1,022	978	1,000
2Q	319	405	423	398	427	501	737	980	976	1,237	820	
3Q	322	424	415	406	456	552	812	1,005	945	1,566	937	
4Q	334	448	413	410	470	623	913	1,013	952	1,403	1,008	
Average	326	412	424	403	442	540	780	991	967	1,312	936	1,000

SN500, December calendar year-ends (US\$/ton)												
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1Q	239	296	386	320	358	436	502	805	930	919	645	890
2Q	230	335	375	316	373	452	540	867	889	1,128	621	
3Q	237	359	362	333	405	473	613	935	853	1,460	830	
4Q	257	383	345	345	423	491	728	967	856	1,082	890	
Average	241	343	367	329	390	463	596	894	882	1,153	746	890

Weekly prices (US\$/ton)				
Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
1,000	1,000	1,000	1,010	1,020

Weekly prices (US\$/ton)				
Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
890	890	890	895	895

Source: ICIS, Kotak Institutional Equities

Castrol has high leverage to exchange rate and raw material prices
Sensitivity of Castrol's earnings to key variables

	CY2009E			CY2010E			CY2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Exchange rate									
Rupee dollar	49.4	48.4	47.4	47.0	46.0	45.0	47.0	46.0	45.0
Net profits (Rs mn)	4,001	4,102	4,203	4,884	4,993	5,102	4,974	5,091	5,208
EPS (Rs)	32.4	33.2	34.0	39.5	40.4	41.3	40.2	41.2	42.1
% upside/(downside)	(2.5)		2.5	(2.2)		2.2	(2.3)		2.3
Raw material price									
Raw material price (US\$/ton)	850	825	800	900	875	850	950	925	900
Net profits (Rs mn)	3,953	4,102	4,250	4,849	4,993	5,137	4,946	5,091	5,237
EPS (Rs)	32.0	33.2	34.4	39.2	40.4	41.5	40.0	41.2	42.4
% upside/(downside)	(3.6)		3.6	(2.9)		2.9	(2.9)		2.9

Source: Kotak Institutional Equities estimates

Castrol: Profit model, balance sheet, cash model, December year-ends, 2004-2011E (Rs mn)

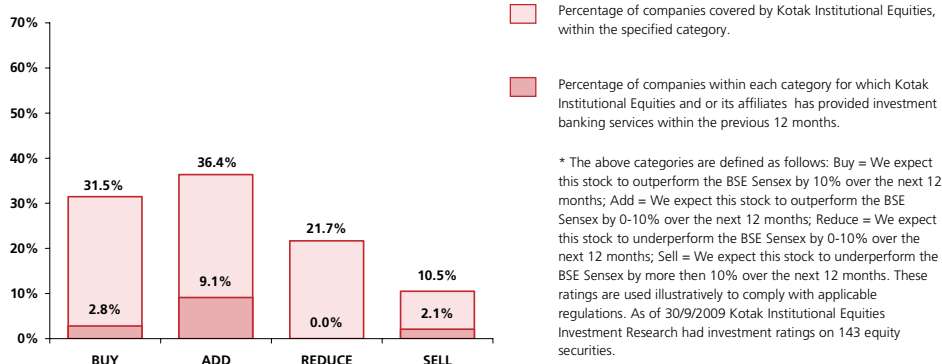
	2004	2005	2006	2007	2008	2009E	2010E	2011E
Profit model (Rs mn)								
Net sales	13,051	14,304	17,524	18,883	22,057	23,517	25,411	26,489
EBITDA	2,082	2,117	2,200	3,296	3,997	6,302	7,626	7,729
Other income	221	201	344	348	418	325	375	425
Interest	(29)	(30)	(41)	(38)	(37)	(32)	(51)	(51)
Depreciation	(249)	(189)	(180)	(208)	(257)	(268)	(272)	(276)
Pretax profits	2,026	2,098	2,322	3,398	4,122	6,327	7,677	7,826
Tax	(687)	(694)	(889)	(1,455)	(1,568)	(2,273)	(2,741)	(2,796)
Deferred taxation	9	56	57	236	86	48	57	61
Net profits	1,275	1,468	1,545	2,184	2,624	4,102	4,993	5,091
Earnings per share (Rs)	10.7	11.8	12.2	17.6	21.3	33.2	40.4	41.2
Balance sheet (Rs mn)								
Total equity	3,601	3,901	4,177	4,302	4,756	5,386	6,618	7,948
Deferred taxation liability	174	119	61	(182)	(268)	(316)	(373)	(433)
Total borrowings	37	28	28	28	28	19	16	13
Current liabilities	2,830	3,238	3,619	5,116	4,690	3,895	3,996	4,132
Total liabilities and equity	6,642	7,285	7,885	9,264	9,205	8,984	10,257	11,660
Cash	297	399	892	3,179	2,556	1,919	3,014	4,281
Current assets	3,558	4,422	5,271	4,546	5,199	5,734	6,033	6,296
Total fixed assets	1,498	1,383	1,297	1,333	1,445	1,327	1,204	1,078
Investments	1,289	1,081	425	206	5	5	5	5
Total assets	6,642	7,285	7,885	9,264	9,205	8,984	10,257	11,660
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	1,576	1,544	1,403	2,046	2,772	3,997	4,833	4,882
Working capital	24	(465)	(506)	1,484	(1,193)	(1,329)	(199)	(127)
Capital expenditure	(57)	(89)	63	(243)	(371)	(150)	(150)	(150)
Free cash flow	1,542	991	960	3,287	1,208	2,517	4,485	4,605
Investments	(402)	258	687	224	201	—	—	—
Other income	37	25	9	151	210	325	375	425
Ratios (%)								
Debt/equity	1.0	0.7	0.7	0.7	0.6	0.4	0.3	0.2
Net debt/equity	1.0	0.7	0.7	0.7	0.6	0.4	0.3	0.2
RoAE	34.3	37.7	37.4	52.3	61.0	85.8	88.3	74.0
RoACE	35.7	37.7	37.0	52.4	61.4	85.8	88.6	74.3

Source: Company, Kotak Institutional Equities estimates

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Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of September 30, 2009

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ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

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