



CHEVRON LUBRICANTS LANKA PLC

CSE: LLUB.N0000

Bloomberg: LLUB SL

HOLD

Nov 2017 Current Price – LKR 117.8 Fair value – LKR 128.0 Buy Below Price - LKR 117.5 3Q2017 Earnings ↓ 34%YoY

KEY DATA

Share Price (LKR)	117.8		
52w High/Low (LKR)	178.5/109.9		
Average Daily Volume (Shares)	96,427		
Average Daily Turnover ('000)	14,054		
Issued Share Capital (Shares mn)	240.0		
Market Capitalisation (LKR mn)	28,656		
Price Performance (%)	1 mth	3 mths	12mths
LLUB	2.1%	-8.2%	-25.2%
ASPI	-1.7%	1.2%	2.1%

Major Shareholders as at 30th Sep 2017

Chevron Ceylon Limited	51.00%
Renuka Hotels Limited	5.25%
BNYM SA/NV- Blackrock Frontiers Investm	2.56%
BNYM SA/NV-NEON LIBERTY EMERGING M	2.26%
RBC Investor Services Bank- COELI SICAV I-	1.93%

Public Holdings 49.00%

Price – Volume Chart



ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 6.

“Slower growth; Sizable payout”

Y/E 31 Dec	2015	2016	2017E	2018E	2019E
Revenue (LKR mn)	11,564	12,089	10,782	12,008	13,299
Net Profit (LKR Mn)	3,092	3,480	2,612	2,713	2,855
YoY % Growth	13%	13%	-25%	4%	5%
EPS (LKR)	12.9	14.5	10.9	11.3	11.9
YoY % Growth	13%	13%	-25%	4%	5%

LKR (Mn)	3Q2017	3Q2016	YoY	9M2017	9M2016	YoY
Revenue	2,847	3,225	↓ -11.7%	8,246	9,144	↓ -9.8%
Gross Profit	1,193	1,576	↓ -24.3%	3,618	4,398	↓ -17.7%
EBIT	879	1,311	↓ -32.9%	2,669	3,635	↓ -26.6%
Income tax expense	(236)	(348)	↓ -32.1%	2,742	3,783	↓ -27.5%
Profit for the year	659	1,001	↓ -34.1%	2,009	2,789	↓ -28.0%

LKR (Mn)	4Q2016	1Q2017	2Q2017	3Q2017	QoQ
Revenue	2,946	3,118	2,281	2,847	↑ 24.8%
Gross Profit	1,273	1,402	1,023	1,193	↑ 16.6%
EBIT	881	1,089	701	879	↑ 25.4%
Income tax expense	(227)	(296)	(202)	(236)	↑ 17.1%
Profit for the year	693	822	527	659	↑ 25.1%

Disclosure on Shareholding:

First Capital Group and its affiliates holding 32,500 shares of LLUB and will not trade in this share for the three trading days following the issue of this document.

FC Research recommend LLUB to HOLD: LLUB continued its suffering with a further dip by 34%YoY as volumes take a hit amidst tight economic conditions and lower competitor pricing. Further, the extreme weather conditions (Drought and Floods) that prevailed during 1H2017 also added fuel, adversely impacting retail consumption. Flood condition impacted lubricant usage by automobile while drought impacted lubricant consumption by the agriculture sector. In addition, drop in volume continued as a result of subdued consumer spending and a **12% price hike in April 2017** which produce intense competition in the market, eroding LLUB's market share led by price sensitive customer shifting to cheaper alternatives. In order to recapture lost market during the latter part of 3Q 2017, **LLUB offered 25% discounts for its 210 Liter products or oil drum**, which accounts for 40% of the sales mix making them more competitive in the market. LLUB offering discounts to maintain volumes may be detrimental to its overall margins which are likely to further dip from 46.9% to c.43.3% in 3Q2017. We believe market volumes are likely to be slow over the next couple of quarters as well, amidst slow economic conditions while consumer demand is likely to improve towards 2H2018 business as consumer sentiment slowly recover amidst continued stability. We expect LLUB earnings growth to remain slow with margins around the 43%-44% mark. FC Research expects LLUB fair value to be at LKR 128.0 and recommends a **HOLD**.



Earnings Performance

Lower volumes translate to revenue losses: LLUB 3Q2017 revenue fell 12%YoY to LKR 2.8Bn on the back of continued decline in volumes from the retail segment which constitutes almost 60% of overall volume. LLUB's 9M2017 revenue fell 10%YoY to LKR 8.2Bn.

Price adjustments and slower economic conditions hit volumes: Tighter monetary policy slowed consumer spending negatively affecting LLUB volumes in 2017. However, in spite of the lower spending LLUB went ahead with c.12% upward price revision in April 2017 resulting in significant drop in volumes eroding LLUB's market share as competition refrained from raising prices. Finally in the latter part of 3Q2017 LLUB offered attractive discounts of 25% on 210 Liter products or oil drum which is LLUB's most sold product, accounting for 40% of the product mix. The intention was to recapture lost volumes. However, by introducing the discounting the latter part of 3Q2017, further hampered revenue during the quarter.

Adverse weather patterns fuelled lower consumption in the market: Overall market volumes of the industry were also heavily affected by the drought and floods that took place during the 1H2017. Lower consumption affected by these weather patterns had a spillover effect on 3Q2017 as well. Flood condition impacted lubricant usage by automobile while drought impacted lubricant consumption by the agriculture sector.

Less contribution from higher margin segment continue to impact gross margins: LLUB's 9M2017 gross margin dropped 422bpsYoY to 43.9%, while 3Q2017 margin down 694bpsYoY to 41.9% due to a 20%YoY increase in base oil prices. Main reason for the margin contraction is lesser contribution from higher

margin retail segment. In addition the 25% discount offered on their most popular product also contributed towards the drop in margins.

Higher than expected Selling & Distribution expenses: On the back of a c.19%YoY incline in OPEX as administration costs inclined by +30%YoY to LKR 169.0Mn in 3Q2017 and distribution expenses inclined by +7%YoY to LKR 145.8mn.

Investment case

LLUB fair value to be at LKR 128.0: FC Research expect LLUB's earnings to record at c.LKR 827Mn for 2018E, growing by 4%YoY. We expect a fair value of LKR 128.2 [LKR 137.1 DCF based and LKR 119.3 PER based] providing an annualized return of c.+14.4% for FY19E. (Total return of c.+17% includes a dividend yield of c.8%) at current market price of LKR 117.8

Base oil price expected to remain at current level for the next quarters. However the reduction in the average selling price in latter part of 3Q2017 may increase pressure on 4Q2017 and full year 2017 gross margin to fell at 43.3% compared to 46.9% in 2016.

As per the PUCSL end 2016, LLUB market share stood at 45%. FC Research expect on the back of competition market share will erode to 43% in 2018. LLUB Awarded the contract to supply 1.1mn liters of lubricant oil to the Sapugaskanda Power Plant for the year 2017/2018. Improvement in commercial vehicle segment along with the growing second hand personal vehicle market FC Research expect retail lube segment to drive the volume in 1H2018.

Investment risks

Business Risk via Loss of Volumes/ Market Share: Company faces the risk of losing volumes due to negative market growth, intense competition from the existing players, new entrants and unlicensed operators in the market who resort to selling adulterated products. There is no effective regulatory mechanism to curb such illegal activities which affect the industry. The export volumes may be affected by macro-economic developments, political unrest and fiscal policies of the respective geographies.

Foreign Exchange Risk: As most of the raw materials are imported, the depreciation of the rupee against the US dollar affects the product acquisition costs adversely.



Valuation summary

	2018E
Expected LLLU Price	2018E
DCF Valuations based Target Price	137.1
PER based Target Price	118.7
Average Target Price	127.9
Target Price (Rounded Up)	128.0

LLUB Return	2018E
Target Price	128.0
Current Price	117.8
Capital Gain (LKR)	10.2
Dividend (LKR)	9.8
Capital Gain %	9%
Dividend Yield %	8%
Total Return %	17%
Annualised Return	14%

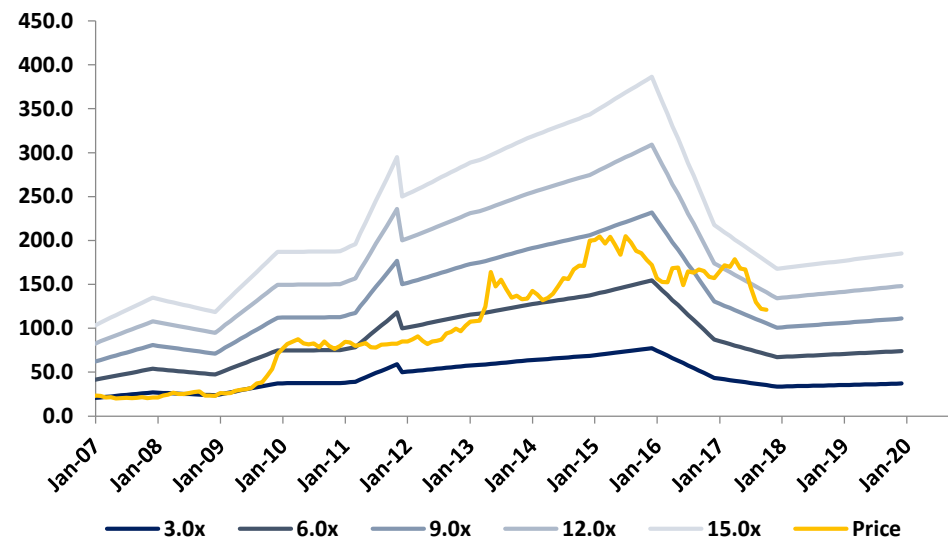
DCF Base valuation

Valuations	2018E
Enterprise Value	30,514
Debt (-)	-
Cash (+)	2,392
Total Value of Equity	32,906
No. of Shares	240
Value of Equity per Share	137.1

WACC	
K_e	18%
$K_d (1-t)$	12%
D/E Assumption	40 / 60
Terminal Growth (%)	3%
WACC	16%

COE (K_e)	
R_f	9%
R_m	17%
β	1.12
$K_e = R_f + \beta (R_m - R_f)$	18%

PER Valuation



Source: CSE and Research Estimates

PER based Valuation	2018E
Earnings (LKR 'Mn)	2,713
No. of Shares ('Mn)	240
FY18E EPS	11.3
Expected Average PER	11
Price at 11.0x 2018E Earni	118.7

Recommendation criteria

Categorization	Company Category	Strong Buy	Buy	Hold	Sell
Grade A	S&P SL20 Companies	T.Bill + 10% & Above	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Grade B	Rest of the Companies	T.Bill + 13% & Above	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 16% & Above	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%

Note: 1 year T-bill rate as of 15 Nov 2017: 9.46%



Annex I – Income Statement

Profit & Loss Statement					
Y/E 31 December	2015	2016	2017E	2018E	2019E
Revenue	11,564	12,089	10,782	12,008	13,299
Cost of sales	(6,368)	(6,418)	(6,116)	(7,040)	(8,021)
Gross profit	5,196	5,671	4,666	4,968	5,278
Other operating income	11	3	11	12	13
Selling and distribution	(502)	(538)	(593)	(720)	(798)
Admin expenses	(562)	(534)	(664)	(711)	(761)
EBIT	4,143	4,515	3,419	3,548	3,733
Finance Income	175	187	209	220	232
PBT	4,319	4,703	3,628	3,768	3,965
Taxation	(1,227)	(1,222)	(1,016)	(1,055)	(1,110)
Net Profit for the Period	3,092	3,480	2,612	2,713	2,855
Super Gains Tax	(863)	-	-	-	-
Net Profit for the Period	2,228	3,480	2,612	2,713	2,855
Adjusted EPS	9.29	14.50	10.88	11.31	11.90

Source: Company Annual Reports and FC Research Estimates

Annex II – Balance Sheet

Balance Sheet					
As at 31 December	2015	2016	2017E	2018E	2019E
Assets					
Non current assets					
Property plant and equipment	2,196	2,133	2,182	2,067	1,959
Non current receivables	90	75	75	75	75
	2,286	2,208	2,257	2,142	2,034
Current Assets					
Inventories	1,309	1,790	1,596	1,778	1,969
Receivables and prepayment	1,111	1,139	1,016	1,131	1,253
Short term investments	-	-	-	-	-
Cash and cash equivalents	2,339	1,910	2,176	2,392	2,565
	4,759	4,839	4,788	5,301	5,787
Total Assets	7,045	7,047	7,045	7,443	7,820
Equity and Liabilities					
Capital and reserves					
Ordinary shares	600	600	600	600	600
Retained Earnings	4,087	3,261	3,522	3,739	3,882
	4,687	3,861	4,122	4,339	4,482
Non - current liabilities					
Deferred tax liabilities	174	120	120	120	120
Defined benefit obligation	126	246	246	246	246
	299	366	366	366	366
Current liabilities					
Trade and other payables	1,347	2,139	1,908	2,125	2,353
Current tax liabilities	712	681	528	492	499
Borrowings	-	-	-	-	-
	2,059	2,820	2,436	2,617	2,852
Total liabilities	2,358	3,186	2,802	2,983	3,218
Total equity & liabilities	7,045	7,047	6,923	7,322	7,699
Adjusted BVPS	19.53	16.09	17.17	18.08	18.67

Source: Company Annual Reports and FC Research Estimates



Annex III – Cash Flow Statement

Cashflow Statement					
Y/E 31 December	2015E	2016	2017E	2018E	2019E
Net profit before tax	4,319	4,703	3,628	3,768	3,965
Adjustments	-	-	-	-	-
Changes in Working Capital	143	151	185	224	212
Interest received	(160)	(145)	(190)	(200)	(210)
Interest paid	0	0	-	-	-
Defined Benefit Obligations paid	37	45	-	-	-
Tax Paid	20	51	(5)	24	2
Net cashflow from operating activities	4,358	4,804	3,617	3,816	3,970
Investing Activities					
Fixed Assets	(95)	(91)	(113)	(109)	(103)
Net cashflow from investing activities	(95)	(91)	(113)	(109)	(103)
Financing Activities					
Dividends	(2,040)	(4,200)	(2,351)	(2,496)	(2,712)
Net Cashflow from financing activities	(2,040)	(4,200)	(2,351)	(2,496)	(2,712)
Net cash and cash equivalents	1,049	(429)	266	216	173
Cash and cash equivalents at beginning of year	1,290	2,339	1,910	2,176	2,392
Cash and cash equivalents at end of year	2,339	1,910	2,176	2,392	2,565

Source: Company Annual Reports and FC Research Estimates

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