



CHEVRON LUBRICANTS PLC [LLUB.N0000]

MAINTAIN BUY

“UNLOCKING POTENTIAL”

Fair Value: 2023E - LKR 130.0 [+41%]

Total Return with DPS: 2023E - 48% [AER 172%]

2024E - LKR 160.0 [+74%]

2024E - 87% [AER 56%]

LLUB net profit declined by 5.4%YoY to LKR 794.4Mn, +2.5% variance from our 2Q2023 estimate. The decline in profitability during the quarter was largely attributable to the overall slowdown in the lubricant volumes and reduction of prices up to 45%, which was reflected on the topline performance of the business (-13.7%YoY to LKR 5.3Bn). Furthermore, as expected overall business margins took a stumble in 2Q2023 (GP margin fell by 16.3ppYoY to 30.3% whilst EBIT fell by 15.5ppYoY to 19.0%) with the change in corporate strategy to enhance volumes and market share via the change in focus from the sale of high margin 4L cans to selling low margin loose oil. This strategy has augured well for LLUB with PUCSL 1Q2023 reflecting a volume growth of 26.0%QoQ (bouncing back after reporting three consecutive quarters of decline) whilst improving the market share to 48.6% in 1Q2023 from 41.7% in 4Q2022. Going forward, we expect the current growth trajectory for lubricant volumes to continue, aided by the recovery of economy (service PMI bounced back in Jun-23 and recorded the highest value since Jan-22) and business confidence (LMD business confidence index improved to 103 points in Jun-23 cf. 72 points in Mar-23), improvement in travel and movement benefitted by the possible complete relaxation of fuel quota system, overall improvement in new registration of motor vehicles with the possible relaxation of the import ban imposed on vehicle imports in 2024E and recovery in tourism and related auxiliary businesses. Furthermore, having paid just one dividend in Nov-22 of LKR 5.0/share in 2022, LLUB announced the first interim dividend of LKR 2.0/share on Jul-23, paving the way to achieve our forecasted payout of 40.0% in 2023E, which offers an attractive DY of 6.7%. With the recovery of lubricant volumes, we believe that LLUB is on its way to increase its payout to 60.0% and 80.0% in 2024E and 2025E, respectively reaching the pre-pandemic payout of +90.0% in 2026E whilst offering an attractive DY of 12.6% and 21.1% for 2024E and 2025E, respectively. Taking into consideration the future and attractive dividend yield outlook, significant discount to the historical trading multiples, we have arrived at a TP of LKR 130.0 for 2023E and LKR 160.0 for 2024E. Thus, maintaining our recommendation **BUY**.

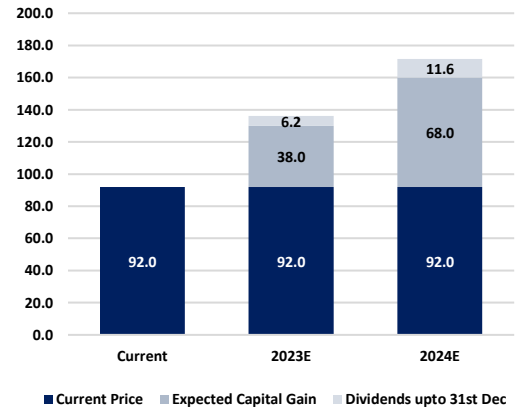
LKR (Mn)	2Q2022	2Q2023	YoY	1H2022	1H2023	YoY
Earnings (LKR 'Mn)						
Revenue	6,174	5,327	-14%	13,876	11,577	-17%
Gross Profit	2,878	1,616	-44%	6,194	3,696	-40%
Operating Profit	2,129	1,009	-53%	4,873	2,466	-49%
PBT	1,027	1,142	+11%	2,187	2,813	+29%
Net Profit	840	794	-5%	1,783	1,960	+10%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	5,515	8,125	+47%	5,515	8,125	+47%
Borrowings	NA	NA	NA	NA	NA	NA
NAVPS	23	34	+47%	23	34	+47%

LLUB net profit down 5.4%YoY to LKR 794.4Mn, +2.5% variance from our 2Q2023 estimate

LLUB reported a net profit decline of 5.4%YoY to LKR 794.4Mn, +2.5% variance from our 2Q2022 estimate of LKR 775.0Mn. The decline in profitability was largely attributable to the overall slowdown in the lubricant industry, with volumes affected by less discretionary income amidst steep tax hikes. LLUB revenue for 2Q2023 declined by 13.7%YoY (-14.8%QoQ) to LKR 5.3Bn, partly due to steep price reductions carried out by the company (up to 45% reduction across all brands) whilst poor volumes also contributed towards the woes. According to the PUCSL, total lubricant industry in Sri Lanka declined by 49.5%YoY to 10,395.2Kl in 1Q2023 affected by the higher base yet grew for the second consecutive quarter by 8.2%QoQ as Sri Lanka emerged from the recession with the recovery of travel and business activities (SL manufacturing PMI reported a dip in Jun-23 whilst Service PMI rebounded and recorded the highest value since Jan-22). LLUB volumes too followed the overall industry trend and recorded a decline of 54.4%YoY to 5,049.3Kl, yet rebounded for the 1st time after 3 quarters by 26.0%QoQ in 1Q2023. However, despite the slowdown in overall volumes, LLUB expanded the market share to 48.6% in 1Q2023 cf. 41.7% in 4Q2022.

Margins remain depressed amidst shift in product mix

Poor topline performance also reflected on the Gross Profit, which declined by 43.9%YoY to LKR 1,615.7Mn whilst GP Margin contracted to 30.3% in 2Q2023 cf. 33.3% in 1Q2023 and 46.6% in 2Q2022. The anticipated change in product mix (from high margin 4L can sales to low margin loose oil sales due to LLUB's concentration on volume growth and aggressive consolidation of market share), LKR depreciation cf. the USD and recent changes to the custom import duty structure caused the poor performance in the GP margins. Meanwhile, Operating profit for 2Q2023 declined by 52.6%YoY to LKR 1.0Bn whilst Operating Profit margin also contracted by 15.5pp YoY to 19.0%. Despite the decline in EBIT and margin, Operating expenses for 2Q2023 declined by 19.2%YoY to LKR 606.5Mn due to the decline in S&D Expenses and Admin



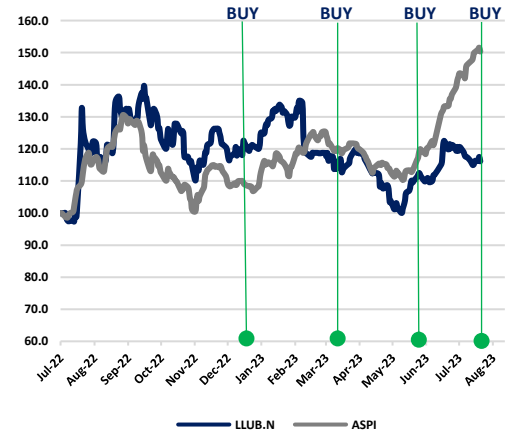
FIRST CAPITAL RESEARCH

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Price movement of LLUB vs ASPI (indexed and rebased to 100)



Source: CSE

Minimum Return for BUY:

Buy Below 2024E - [AER of 23% with DPS]: LKR 126.0
LLUB categorized as 'Grade B' counter

Disclosure on Shareholding:

First Capital Group or the covering analyst did not hold 1% or more of the total outstanding share capital of LLUB during the five trading days prior to the issuance of this document.

LLUB dividends on track to achieve a payout of 40.0%

Having paid out only one dividend amounting to LKR 5.0/share in Nov-22 (dividend payout 32.7%), LLUB announced the first interim dividend of LKR 2.0/share on Jul-23. As economic crisis eases in the country and operations normalizes, we expect LLUB to increase the dividend payout to 40.0% and pay a DPS of LKR 6.20/share for 2023E whilst offering a dividend yield of 6.7%. However, we expect dividend payout to gradually improve to 60.0% and 80.0% in 2024E and 2025E, whilst offering a dividend yield of 12.6% and 21.1%, respectively.

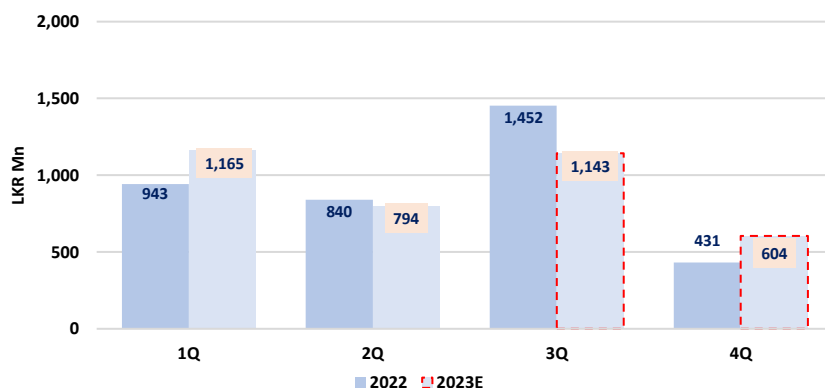
TP revised down to LKR 130.0 for 2023E and LKR 160.0 for 2024E

Despite LLUB reporting 2Q2023 earnings in-line with our estimates (+2.5% variance), we are revising down our target price for 2023E to LKR 130.0 from LKR 150.0 and 2024E target price to LKR 160.0 from LKR 170.0. The downward revision in target price was largely attributable to the increase in working capital (increased by LKR 1.1Bn QoQ and LKR 8.2Bn YoY to LKR 6.7Bn) as inventories picked up sharply to LKR 7.1Bn from LKR 3.5bn in 1Q2023 as overall slowdown in the lubricant industry and inventory buildup with distributors as a result of the sharp price reductions carried out during the 1H2023.

LLUB maintained buy with an upside of 41.3% for 2023E and 73.9% for 2024E

Signing of the IMF agreement in Mar-23 and CBSL relaxing policy rates by 450bps in 2 separate occasions, enabled both Sri Lankan economy (service PMI bounced back and recorded the highest value since Jan-22) and business confidence (LMD business confidence index gained to 103 points in Jun-23 cf. 72 points in Mar-23) to show promising improvement in 2Q2023 (which is reflected on the QoQ growth in lubricant volumes). With economic and political risk easing, we expect the current recovery trajectory to continue whilst expected removal of the fuel quota, possible relaxation of the ban imposed on vehicle imports in 2024E and uptick in tourist arrivals is expected to poise well for LLUB as well as total lubricant industry in the coming years. Amidst a promising outlook whilst trading at a historical low PE of 6.0x on 2023E earnings, we believe the LLUB share is at a steep discount and should re-rate and trade at its past 5Yr average PE of 9.0x. Taking in to consideration the potential upside on the share of 41.3% to 2023E TP of LKR 130.0 and 73.9% to 2024E TP of LKR 160.0, we continue to rate the LLUB share **MAINTAIN BUY**.

Quarterly Earnings



Valuation Table

YE Dec/LKR Mn	2020	2021	2022	2023E	2024E	2025E
Estimates (LKR 'Mn)						
Revenue	11,637	16,866	24,575	22,086	26,465	31,962
Gross profit	4,617	6,178	10,287	9,276	11,248	13,744
EBIT	3,036	4,363	7,496	6,524	7,553	8,802
Net Profit	2,226	3,926	3,666	3,706	4,639	5,814
Adjusted EPS (LKR)	9.3	16.4	15.3	15.4	19.3	24.2
YoY Growth (%)	6.0%	76.4%	-6.6%	1.1%	25.2%	25.3%
Valuations						
PER (x)	9.9x	5.6x	6.0x	6.0x	4.8x	3.8x
PBV (x)	5.3x	4.4x	3.6x	2.6x	2.2x	1.9x
DPS	9.0	13.0	5.0	6.2	11.6	19.4
DY (%)	9.8%	14.1%	5.4%	6.7%	12.6%	21.1%
Dividend Payout (%)	97.0%	79.5%	32.7%	40.0%	60.0%	80.0%
NAVPS	17.4	20.8	25.7	34.9	42.7	47.5

Estimate Revision

In LKR Mn	FY23E-O	FY23E-R	% Change	FY24E-O	FY24E-R	% Change
Earnings Estimate						
Revenue	22,398	22,086	-1%	26,840	26,465	-1%
Gross Profit	9,407	9,276	-1%	11,407	11,248	-1%
EBIT	6,616	6,524	-1%	7,660	7,553	-1%
Profit before Tax	5,387	5,295	-2%	6,908	6,627	-4%
Net Profit	3,771	3,706	-2%	4,836	4,639	-4%
Adjusted EPS	15.7	15.4		20.2	19.3	
Balance Sheet Estimate						
Shareholders' Equity	7,295	8,383	+15%	5,449	10,239	+88%
Borrowings	NA	NA	NA	NA	NA	NA
Adjusted NAVPS	30.4	34.9		34.4	42.7	



Valuation Summary

Expected LLUB Price	2023E	2024E
PER Valuation based target price	123.5	154.6
DCF Valuation based target price	119.4	164.5
Average Target Price	121.5	159.6
Target Price after Rounding off	130.0	160.0

Return	2023E	2024E
Target Price	130.0	160.0
Current Price	92.0	92.0
Capital Gain (LKR)	38.0	68.0
Dividends upto 31 Dec (LKR)	6.2	11.6
Capital Gain %	41%	74%
Dividend Yield %	7%	13%
Total Return %	48%	87%
Annualized Return %	172%	56%

Discounted Cash flow Valuation

DCF based Valuation	2023E	2024E
Enterprise Value	25,122	32,677
Debt (-)	(393)	(393)
Cash (+)	3,920	7,203
Total Value of Equity	28,649	39,487
No. of Shares (Mn)	240	240
Target Price	119.4	164.5

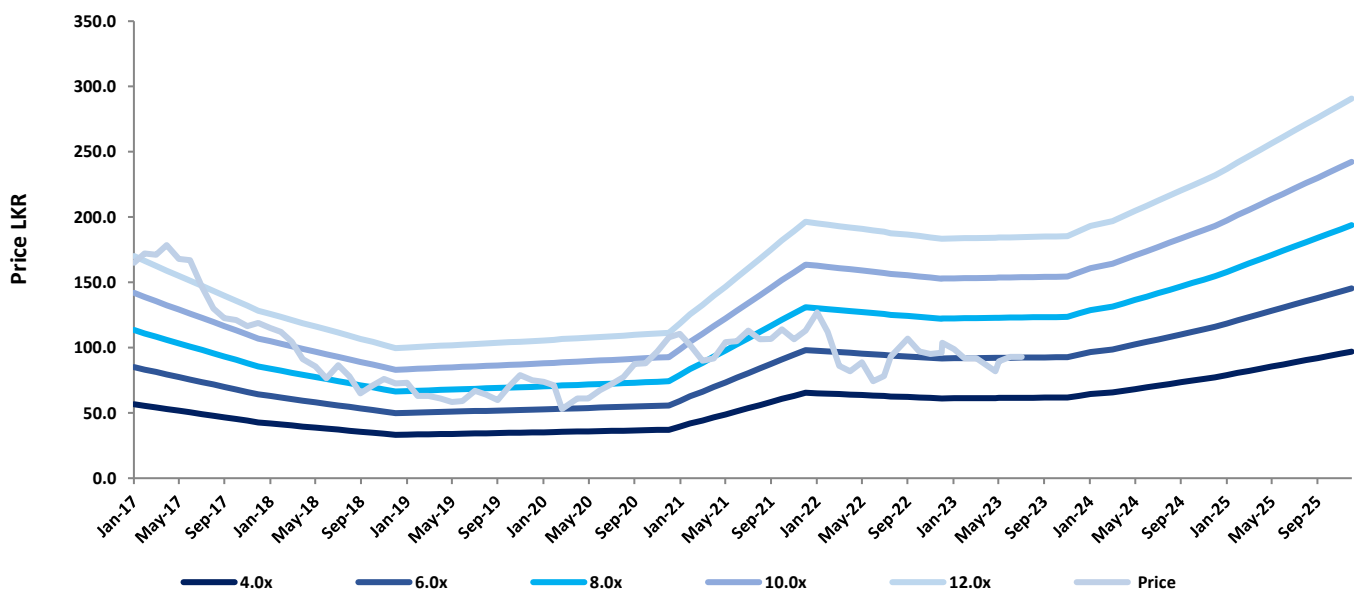
COE	2023E	2024E
Rf	15%	12%
Rm	23%	20%
Growth %	3%	3%
β	1.30	1.30
$K_e = R_f + \beta(R_m - R_f)$	25%	22%

PER valuation

PER based Valuation	2023E	2024E
Earnings (LKR 'Mn)	3,706	4,639
No. of Shares ('Mn)	240	240
EPS	15.4	19.3
Expected PER	8x	8x
Price at 8x Earnings	123.5	154.6

WACC	2023E	2024E
K_e	25%	22%
K_d	18%	18%
D/E Assumption	10/90	10/90
Terminal Growth (%)	5%	5%
WACC	24%	21%

PER Chart



Appendix I: Statement of Income and Expenses

Profit & Loss Statement									
Y/E 31 December	2017	2018	2019	2020	2021	2022	2023E	2024E	2025E
Revenue	11,052	10,861	11,856	11,637	16,866	24,575	22,086	26,465	31,962
Cost of sales	(6,312)	(6,769)	(7,421)	(7,020)	(10,688)	(14,288)	(12,810)	(15,218)	(18,218)
Gross profit	4,741	4,092	4,435	4,617	6,178	10,287	9,276	11,248	13,744
Other operating income	5	8	2	2	8	2	9	10	12
Selling and distribution	(659)	(637)	(789)	(778)	(945)	(1,310)	(1,215)	(1,588)	(2,078)
Admin expenses	(681)	(720)	(730)	(808)	(878)	(1,484)	(1,546)	(2,117)	(2,877)
EBIT	3,406	2,743	2,917	3,033	4,363	7,496	6,524	7,553	8,802
Finance Income	90	17	26	63	(31)	(2,496)	(1,229)	(926)	(496)
PBT	3,496	2,760	2,943	3,097	4,333	5,000	5,295	6,627	8,306
Taxation	(931)	(768)	(844)	(874)	(407)	(1,334)	(1,588)	(1,988)	(2,492)
Net Profit for the Period	2,565	1,992	2,099	2,223	3,926	3,666	3,706	4,639	5,814
<i>Adjusted EPS</i>	<i>10.7</i>	<i>8.3</i>	<i>8.7</i>	<i>9.3</i>	<i>16.4</i>	<i>15.3</i>	<i>15.4</i>	<i>19.3</i>	<i>24.2</i>

Appendix II: Statement of Financial Position

Balance Sheet									
As at 31 December	2017	2018	2019	2020	2021	2022	2023E	2024E	2025E
Assets									
Non current assets									
Property plant and equipment	2,067	1,963	1,883	1,758	1,661	1,589	1,535	1,508	1,509
Right-of-use assets	-	-	389	343	302	342	342	342	342
Non current receivables	77	76	74	79	64	70	70	70	70
	2,144	2,040	2,347	2,180	2,028	2,001	1,947	1,919	1,921
Current Assets									
Inventories	2,046	2,756	1,939	2,691	3,760	5,178	5,764	4,565	5,465
Receivables and prepayment	1,266	1,014	1,080	1,082	1,181	1,978	2,429	2,647	3,196
Short term investments	-	-	-	-	-	-	-	-	-
Cash and cash equivalents	140	259	870	1,899	4,025	3,876	3,920	7,203	7,573
	3,452	4,028	3,889	5,671	8,966	11,033	12,114	14,415	16,234
Total Assets	5,596	6,068	6,236	7,852	10,993	13,034	14,061	16,334	18,155
Equity and Liabilities									
Capital and reserves									
Ordinary shares	600	600	600	600	600	600	600	600	600
Retained Earnings	3,407	3,314	3,536	3,580	4,399	5,559	7,783	9,639	10,801
	4,007	3,914	4,136	4,180	4,999	6,159	8,383	10,239	11,401
Non - current liabilities									
Deferred tax liabilities	162	140	147	192	205	283	283	283	283
Defined benefit obligation	246	258	266	247	157	234	234	234	234
Lease liabilities	-	-	359	332	310	358	358	358	358
	408	397	772	771	672	875	875	875	875
Current liabilities									
Trade and other payables	661	1,423	789	2,167	4,739	5,040	3,843	4,261	4,919
Current tax liabilities	405	333	502	699	552	925	925	925	925
Lease liabilities	-	-	36	34	31	35	35	35	35
Borrowings	115	-	-	-	-	-	-	-	-
	1,181	1,756	1,327	2,900	5,322	5,999	4,803	5,220	5,878
Total liabilities	1,589	2,153	2,099	3,671	5,995	6,875	5,678	6,096	6,754
Total equity & liabilities	5,596	6,068	6,236	7,852	10,993	13,034	14,061	16,334	18,155
<i>Adjusted BVPS</i>	<i>16.7</i>	<i>16.3</i>	<i>17.2</i>	<i>17.4</i>	<i>20.8</i>	<i>25.7</i>	<i>34.9</i>	<i>42.7</i>	<i>47.5</i>



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