VISIT NOTE | 12 DEC 2014

Gulf Oil Lubricants

NOT RATED

INDUSTRY			LUBRICANTS
CMP *(as on 11 Dec 2014)*			Rs 521
Target Price			NA
Nifty			8,293
Sensex			27,602
KEY STOCK DATA			
Bloomberg			GOLI IN
No. of Shares (mn)			50
MCap (Rs bn) / ($ mn)			26/414
6m avg traded value (Rs mn)			-
STOCK PERFORMANCE (%)			
52 Week high / low			Rs 548/221
	3M	6M	12M
Absolute (%)	65.4	-	-
Relative (%)	63.4	-	-
SHAREHOLDING PATTERN (%)			
Promoters			59.95
FIs & Local MFs			7.75
FIIs			12.55
Public & Others			19.75
Source : BSE			

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Firing on all cylinders

With a well-balanced and improving portfolio of lubricant brands, Gulf Oil Lubricants (GOL) is well placed to capitalise on the much anticipated revival in autos and GDP/IIP cycle in India. The recent collapse in crude oil implies softer base oil (key RM) prices, a significant margin lever in the near term.

We are enthused by GOL's (1) Faster than market volume growth (2) Well-entrenched and steadily expanding distribution network of 350 distributors and 50,000 retailers (3) Near doubling of capacity over FY14-16E (4) Sustained investment in brand building [6-7% of sales] (5) Margin expansion (ex-crude, driven by brand building, improving sales mix, operating leverage and better logistics).

Valuations don't seem expensive at 19.7x FY17E EPS, given a debt-free balance sheet, superior return ratios (FY17E RoE : ~44%), multi-year market share growth and a stated dividend payout policy of ~40%. This will most likely lead to a sustainable re-rating on the stock.

Volume focus to aid market share expansion

- The lubricant industry is likely to benefit from the revival in GDP growth (as per GOL's management, lube volumes grow 0.5x GDP). GOL is confident that it will continue to outpace industry volume growth by 2x. Continuous advertisement and brand building efforts (A&P 6-7% of sales) coupled with product innovations have helped GOL post 8.4% volume CAGR over the trailing four years in an adverse macro environment.
- Unlike Castrol, GOL is focused on volume growth and market share. Driven by product innovations and brand building efforts, it has upped market share from 4.4% in FY07 to 6.9% in FY14 in the Bazaar (retail) segment, making it the third largest private lubricant player in India after Castrol and Tide Water (Veedol).

Base oil prices provides margin lever

- GOL directly benefits from the collapse in crude prices (down ~40% YoY). Base oil prices (~63% of COGS) are expected to witness a significant decline. They have softened by 15% in the last month and may correct even more. The benefit of lower RM prices will completely reflect by 4QFY15.
- **Ceteris paribus, for a 1% decline in base oil prices, GOL's margins will increase by 36bps.** GOL is unlikely to pass on the complete benefit to consumers. We envisage an upside risk to our FY16E earnings estimates.

FINANCIAL SUMMARY

Particulars	FY14	FY15E	FY16E	FY17E
Net Sales (in Rs Mn)	8,818	10,062	11,511	13,408
EBIDTA (in Rs Mn)	1,082	1,323	1,777	2,231
Net profit (in Rs Mn)		806	1,060	1,333
EPS (Rs.)		16.3	21.4	26.9
P/E (x)		32.6	24.8	19.7
EV/EBITDA		20.7	15.4	12.2
RoE (%)		42.6	44.3	44.0

Source: Company, HDFC sec Inst Research

Volume focus to aid market share expansion

Volumes to grow 2-3x industry volumes

- The lubricant industry is likely to benefit from the revival in GDP growth (as per GOL's management, lube volumes grow 0.5x GDP). GOL is confident that it will continue to outpace industry volume growth by 2x. Continuous advertisement and brand building efforts (A&P 6-7% of sales) coupled with product innovations have helped GOL post 8.4% volume CAGR over the trailing four years in an adverse macro environment.
- GOL has been consistently launching differentiated and innovative products. The company was the pioneer in long drain diesel engine oils. In addition, they were the first to launch 10,000kms drain interval motor cycle oil (Gulf Pride 4T Plus 20W-40) when others were at 5,000kms.

As per the management, lube volumes grow 0.5x GDP

GOL posted 8.4% volume CAGR over the trailing four yearsas against 2% decline for the industry

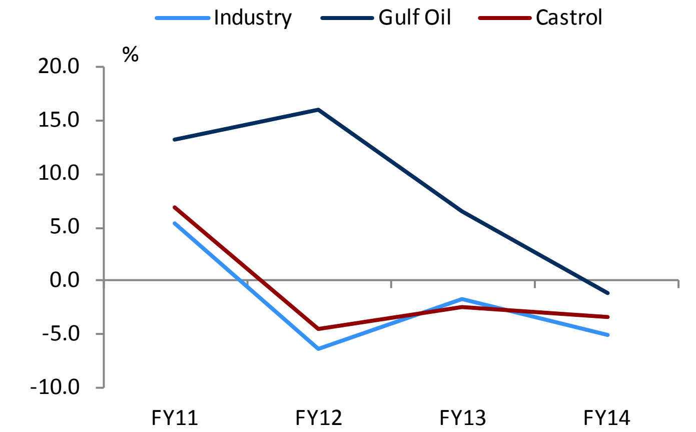
LUBRICANTS VOLUMES

Volumes (mn ltrs)	FY10	FY11	FY12	FY13	FY14	CAGR
Industry	1,538	1,622	1,520	1,493	1,418	-2.0%
Gulf Oil	46	53	61	65	64	8.4%
Castrol*	205	219	209	204	197	-1.0%

* CY

Source: Company, HDFC sec Inst Research

GULF OIL VS INDUSTRY VOLUME GROWTH

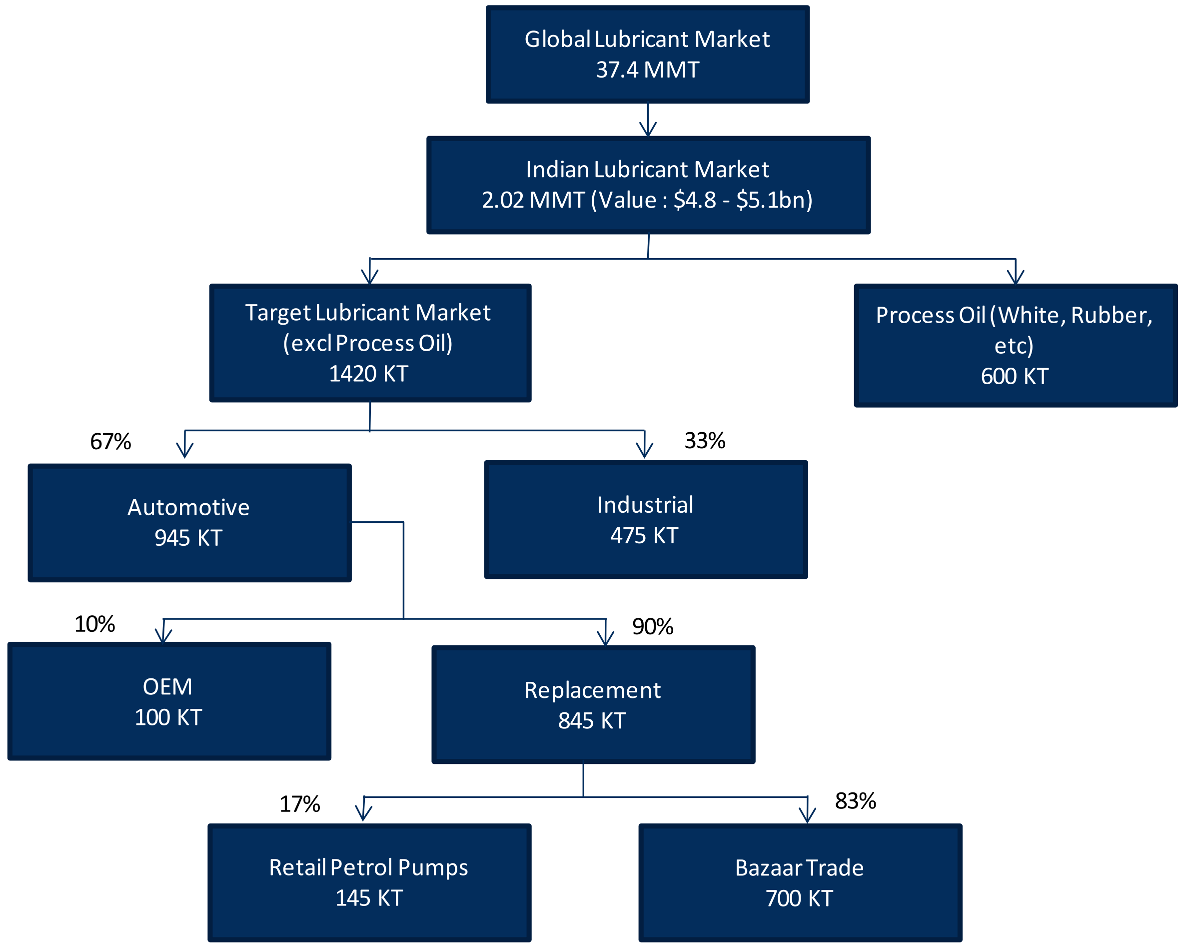


Source: Company, HDFC sec Inst Research

Gaining market share across channels

- Unlike Castrol, GOL is focused on volume growth and market share. Driven by product innovations and brand building efforts, it has upped market share from 4.4% in FY07 to 6.9% in FY14 in the Bazaar (retail) segment, making it the third largest private lubricant player in India after Castrol and Tide (Veedol).

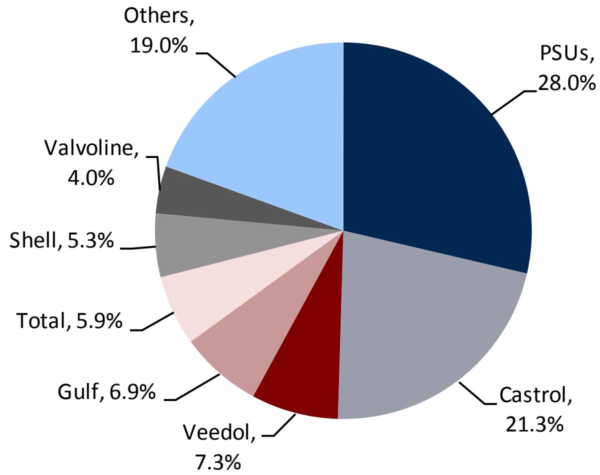
LUBRICANT MARKET 2013-14



Source : Company

GOL has upped market share from 4.4% in FY07 to 6.9% in FY14 in the Bazaar (retail) segment

CURRENT BAZAAR MARKET SHARE



Source: Company, HDFC sec Inst Research

MARKET SHARE GAIN ACROSS CHANNELS

Overall Industry

(%)	2007	2014
Gulf	2.80	4.55
Others	97.20	95.45

Automotive segment

(%)	2007	2014
Gulf	4.40	6.50
Others	95.60	93.50

Bazaar Segment

(%)	2007	2014
Gulf	4.40	6.90
Others	95.60	93.10

Source: Company, HDFC sec Inst Research

Partnerships with Original Equipment Manufacturers (OEMs)

Despite tie-ups with OEMs being a lower margin business, GOL has been entering into partnerships with various OEMs as part of its strategy of gaining market share

- Partnerships with key OEMs across vehicle types are a significant opportunity for lubricant players. Stronger emission norms and demand for fuel efficiency is driving OEMs to continuously develop new engine technologies rapidly. This is expected to translate into demand for lubricants with very specific physicochemical and performance properties and will result in opportunities to introduce more advanced lubricants to cater to the needs of these newer engines in the Indian market.
- Despite tie-ups with OEMs being a lower margin business, GOL has been entering into such partnerships with various OEMs as part of its strategy of gaining market share. Its recent tie-up with Mahindra tractors helped GOL gain an additional 1% market share in the Tractor segment (total market share 5%).

Tie-up with Mahindra tractors helped GOL gain an additional 1% market share in the Tractor segment (total market share 5%)

OEM tie-ups

Source: Company, HDFC sec Inst Research

Within the automotive segment, the company has been successfully increasing its presence in sub segments like New Generation Diesel Engine Oils for Commercial Vehicles and Motorcycle Oils

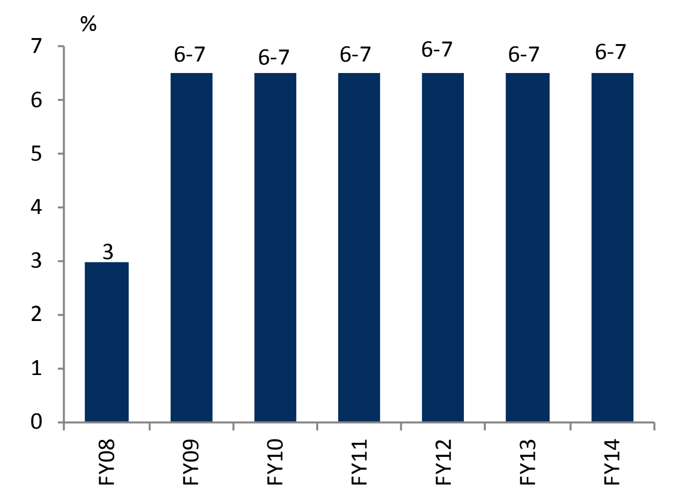
The company plans to increase its current distribution reach by 8-10% each year going ahead

GOL is expanding capacity at Silvassa from 75 kTPA to 90 kTPA by Jan-15 at a cost of Rs 400mn

Sustained brand building efforts & an increasing distribution network to yield rich dividends

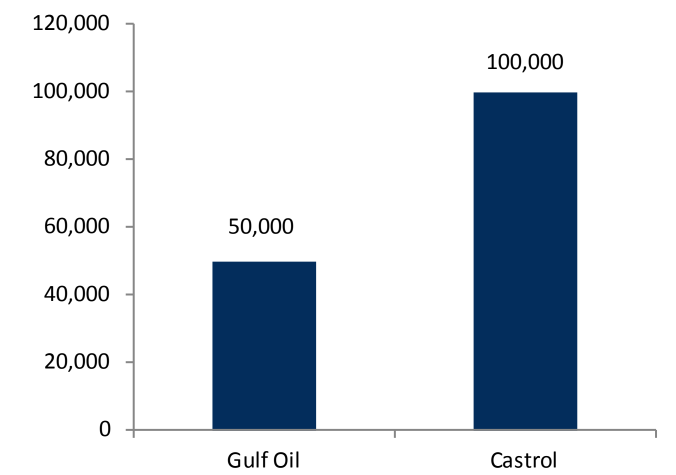
- GOL has, over the last five years, sustainably invested in brand building initiatives. This has paid rich dividends as volumes for GOL grew 8.4% CAGR in the past four years as compared to a decline of 2% CAGR for the industry. The company has maintained its aggressiveness both in ATL and BTL by targeting focused segments (2W, diesel engine oil) to get more bang for its buck.
- Within the automotive segment, the company has been successfully increasing its presence in sub segments like New Generation Diesel Engine Oils for Commercial Vehicles and Motorcycle Oils. GOL plans to increase its focus on the passenger car and tractor lubricant segments.
- GOL's strategy to target focused segments viz. 2Ws and diesel engine oil has been successful. In long drain oil, the company is the No. 1 private player in Tamil Nadu. In 2Ws, GOL has to an 8-10% market share (No. 2 after Castrol). The company has indicated that Tractors and PV will be the next target segments.
- We are enthused by GOL's well-entrenched and steadily expanding distribution network of 350 distributors and 50,000 retailers. The company plans to increase its current distribution reach by 8-10% each year going ahead. This would help narrow the gap with Castrol (100k retail reach).

A&P SPENDS



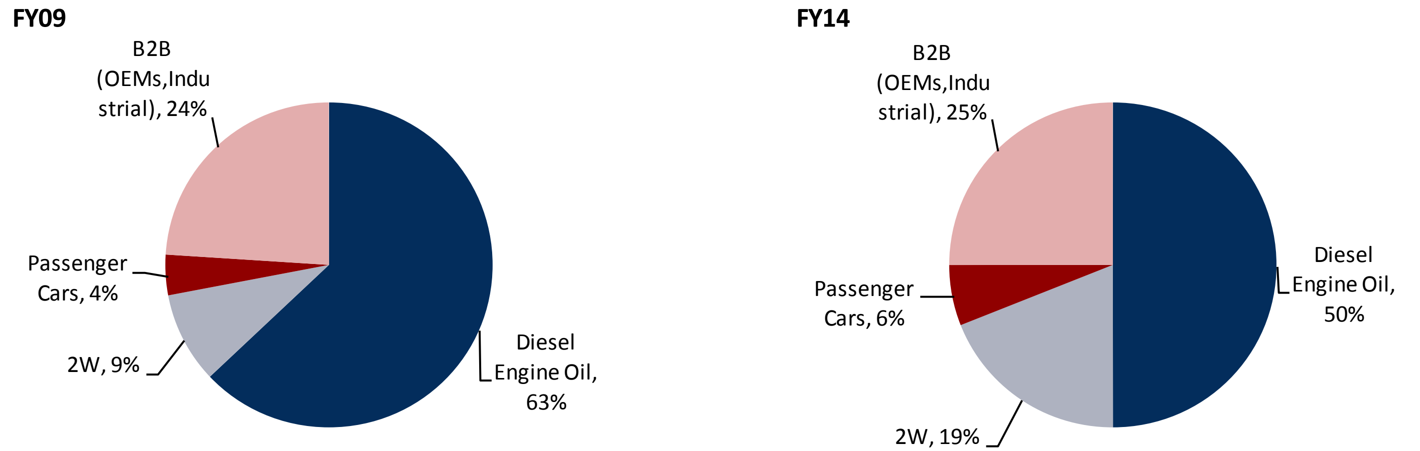
Source: Company, HDFC sec Inst Research

DISTRIBUTION NETWORK



Source: Company, HDFC sec Inst Research

Shift in Segment wise contribution



Source: Company, HDFC sec Inst Research

Capacity expansion

- GOL is expanding capacity at Silvassa from 75 kTPA to 90 kTPA by Jan-15 at a cost of Rs 400mn. It is also commissioning a greenfield unit at Chennai with a capacity of 50 kTPA by end FY16 at a cost of Rs 1.25bn. Funding should not be a concern, given its debt free balance sheet and strong accruals.

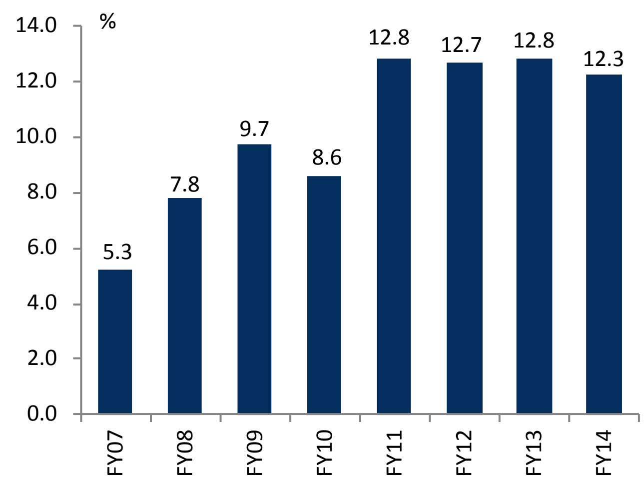
Base oil prices, as per Bloomberg data, has declined by 18% YoY (vs 40% YoY decline for crude)

Easing of supply constraints and low priced crude will most likely lead to a further decline in base oil prices in the coming months

Collapse in crude prices, a significant near term margin lever

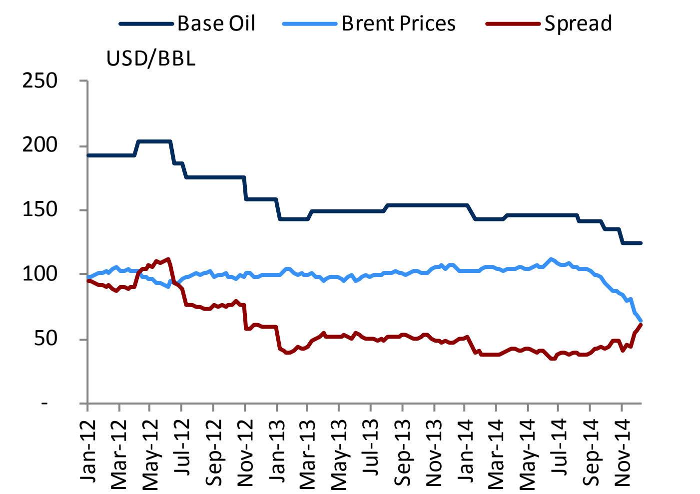
- GOL will benefit the most from the collapse in crude prices (down ~40% YoY). Base oil (~63% of COGS) prices are expected to witness a significant decline, having softened 15% in the last month. The benefit of lower RM prices will completely reflect by 4QFY15.
- Ceteris paribus, for a 1% decline in base oil prices, GOL's margins will increase by 36bps. Unlikely to pass on the complete benefit to consumers, we envisage a significant upside risk to our FY16E earnings estimates.
- Base oil prices, as per Bloomberg data, has declined by 18% YoY (vs 40% YoY decline for crude).
- Currently, Base oil's spread over crude is at USD 61/bbl (highest in past 24 months). Easing of supply constraints and low priced crude will most likely lead to a further decline in base oil prices in the coming months.

EBITDA MARGIN



Source: Company, HDFC sec Inst Research

BASE OIL PRICE TREND



Source: Bloomberg, HDFC sec Inst Research

Upward shift in long term sustainable margins

Structural levers can drive up margins by 200-300 bps over the next two-three years

Commissioning of greenfield plant in Chennai will result in significant savings on freight

- Crude and base oil prices apart, we think there are structural levers that can drive up margins by 200-300 bps over the next two-three years. These include increased pricing power arising out of innovative and cost effective brand building, a new plant in Southern India, improving sales mix and operating leverage. These are the levers that could lead to a sustainable re-rate in valuations.
- The company is planning a new 50kTPA manufacturing unit at Chennai (15 acres of land already acquired), likely to be commissioned by 4QFY16. The Chennai plant will be at close proximity to India's biggest auto hub and port facility. This will result in significant savings on freight as South India has the highest volume share (~30%) for GOL and will yield tax savings on capex.

KEY ASSUMPTIONS

Particulars	FY14	FY15E	FY16E	FY17E
Volumes (mn ltrs)	64	68	75	84
EBITDA margin (%)	12.3	13.1	15.4	16.6
Dividend yield	-	1.2	1.6	2.0

Source: Company, HDFC sec Inst Research

PEER VALUATIONS

Company	CMP (Rs)	Mcap (Rs bn)	Diluted EPS (Rs)			P/E(x)			EV/EBITDA(x)			ROE (%)		
			FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
Gulf Oil Lubricants	**521**	**26**	**16.3**	**21.4**	**26.9**	**32.6**	**24.8**	**19.7**	**20.7**	**15.4**	**12.2**	**42.6**	**44.3**	**44.0**
Castrol#*	502	249	9.9	11.8	13.9	50.6	42.5	36.0	33.5	27.9	23.8	72.7	89.1	94.2

Source: Company, HDFC sec Inst Research * CY # Bloomberg estimates

INCOME STATEMENT

(Rs mn)	FY14	FY15E	FY16E	FY17E
Net Sales	**8,818**	**10,062**	**11,511**	**13,408**
Growth (%)	***4.5***	***14.1***	***14.4***	***16.5***
Material Expenses	-	6,128	6,838	7,931
Employee Expenses	-	402	460	535
A&P Expenses	-	703	804	904
Other Operating Expenses	-	1,507	1,632	1,807
EBIDTA	**1,082**	**1,323**	**1,777**	**2,231**
EBIDTA (%)	***12.3***	***13.1***	***15.4***	***16.6***
EBIDTA Growth (%)	***(0.1)***	***22.2***	***34.4***	***25.5***
Other Income		80	76	87
Depreciation		54	67	84
EBIT		1,349	1,786	2,234
Interest		164	205	235
PBT		1,185	1,582	1,999
Tax		379	522	666
Core PAT		**806**	**1,060**	**1,333**
Core PAT Growth (%)			***31.5***	***25.8***
EO items (net of tax)		-	-	-
RPAT		**806**	**1,060**	**1,333**
RPAT Growth (%)		***(90.5)***	***31.5***	***25.8***

Source: Company, HDFC sec Inst Research

BALANCE SHEET

(Rs mn)	FY14	FY15E	FY16E	FY17E
SOURCES OF FUNDS				
Share Capital		99	99	99
Reserves		2,009	2,573	3,282
Total Shareholders Funds		**2,108**	**2,672**	**3,381**
Total Debt		**1,732**	**1,782**	**1,832**
Deferred Taxes		(2)	(2)	(2)
Long Term Provisions		20	20	20
TOTAL SOURCES OF FUNDS		**3,858**	**4,472**	**5,231**
APPLICATION OF FUNDS				
Net Block		1,280	1,580	1,637
Investments		-	-	-
LT Loans & Advances		25	25	25
Inventories		1,926	2,201	2,560
Trade Receivables		1,238	1,414	1,643
Cash & Equivalents		646	653	952
ST Loans & Advances		157	157	157
Other Current Assets		12	12	12
Current Assets		3,980	4,436	5,324
Trade Payables		963	1,105	1,291
Other Current Liabilities & Provisions		464	464	464
Current Liabilities		**1,428**	**1,569**	**1,755**
Net current Assets		**2,553**	**2,867**	**3,569**
TOTAL APPLICATION OF FUNDS		**3,858**	**4,472**	**5,231**

Source: Company, HDFC sec Inst Research

CASH FLOW

(Rs mn)	FY14	FY15E	FY16E	FY17E
Reported PAT		806	1,060	1,333
Non-operating & EO items		54	51	58
PAT from Operations		752	1,009	1,274
Interest, Dep & Others			272	319
Working Capital Change			(308)	(403)
OPERATING CASH FLOW (a)			**973**	**1,191**
Capex			(400)	(200)
Free Cash Flow			573	991
Investments & Others			-	-
Non-operating income			51	58
INVESTING CASH FLOW (b)			**(349)**	**(142)**
Debt Issuance			50	50
Interest			(171)	(176)
Dividend			(496)	(623)
FINANCING CASH FLOW (c)			**(617)**	**(750)**
Fx effect				
NET CASH FLOW (a+b+c)			7	299
Closing Cash		646	653	952

Source: Company, HDFC sec Inst Research

KEY RATIOS

	FY14	FY15E	FY16E	FY17E
PROFITABILITY (%)				
GPM		39.1	40.6	40.8
EBITDA Margin		13.1	15.4	16.6
EBIT Margin		12.6	14.9	16.0
APAT Margin		8.0	9.2	9.9
RoE		42.6	44.3	44.0
RoIC		23.8	27.5	29.5
RoCE		25.3	28.7	30.7
EFFICIENCY				
Tax Rate (%)		32	33	33
Asset Turnover (x)		2.8	2.8	2.8
Inventory (days)		70	70	70
Debtors (days)		45	45	45
Payables (days)		35	35	35
Cash Conversion Cycle (days)		80	80	79
Debt/EBITDA (x)		1.3	1.0	0.8
Net D/E		0.5	0.4	0.3
Interest Coverage		-	-	-
PER SHARE DATA				
EPS (Rs/sh)		16.3	21.4	26.9
CEPS (Rs/sh)		17.3	22.7	28.6
BV (Rs/sh)		42.5	53.9	68.2
DPS (Rs/sh)		6.5	8.5	10.8
VALUATION				
P/E		32.6	24.8	19.7
P/BV		12.5	9.8	7.8
EV/EBITDA		20.7	15.4	12.2
OCF/EV (%)		-	3.6	4.4
FCF/EV (%)		-	2.1	3.6
Dividend Yield (%)		1.2	1.6	2.0

Source: Company, HDFC sec Inst Research

Rating Definitions

BUY	:	Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL	:	Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL	:	Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure: I, Harsh Mehta, MBA, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.
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