

GULF OIL LUBRICANTS INDIA

OIL & GAS

BUY

Target Price: Rs 1,000

Outperformance continues

Gulf Oil's core volumes grew 7% YoY in Q1FY18 (vs. 10% normal growth) even as GST-led destocking led to 10-15% volume degrowth for peer lubricant players. Volumes are likely to pick up from Aug '17, which will further help Gulf's volume growth and margin (operating leverage). EBITDA margin rose to Rs 23.7/ltr in Q1FY18 (FY17: Rs 21.2/ltr) partly benefitted by price hike taken in May '17. Balance sheet remains strong with net cash at Rs 1.4 bn (RoCE adj. for cash at ~85% vs. unadjusted RoCE at 42%).

Best-placed lubricant player: Gulf has progressed from a B2B player to a premium lubes company over past 7-8 years. Balanced approach to B2B and B2C segments has led to strong volume growth at firm margin. Product portfolio covers entire gamut of auto lubes, with no product gaps. We expect Gulf to gain market share on new product launches (in two-wheelers/cars), OEM tie-ups and brand building. **BUY.**

CMP : Rs 864
Potential Upside : 16%

MARKET DATA

No. of Shares : 50 mn
Free Float : 30%
Market Cap : Rs 43 bn
52-week High / Low : Rs 900 / Rs 568
Avg. Daily vol. (6mth) : 41,003 shares
Bloomberg Code : GOLI IB Equity
Promoters Holding : 70%
FII / DII : 5% / 9%

Hike estimates and TP; maintain BUY

We increase our FY18/19 EPS estimates by ~5% each to factor in (a) higher EBITDA margin at Rs 24/ltr vs. Rs 21.5/ltr earlier and (b) lower volume growth at 7.5% YoY in FY18 vs. 10% assumed earlier (FY19 growth maintained at 10%). We increase our P/E valuation multiple to 30x FY19 EPS (27x earlier) to reflect (a) consistent above-industry volume growth rates along with margin expansion and (b) strong financials: Net cash/Equity at 0.4x, RoCE/RoE of 35-42% (RoCE adjusted for cash at ~85%) and FY17-19E EPS CAGR of 20%. **We hike our TP to Rs 1,000 (vs. Rs 860 earlier).**

Strong financials underpinned by volume growth and margin expansion

- ◆ **Volume growth:** We assume volume growth of 7.5%/ 10% YoY in FY18/19E. Our growth assumption is conservative, as it does not factor in following over next 2 years: (a) renewal of bulk institutional order and (b) any new OEM tie-ups. Note that Gulf has a strong history of 2-3 new OEM tie-ups every year over the past 4-5 years
- ◆ **Firm margin:** Margin should structurally improve (ex-crude) led by (a) higher share of high-margin passenger vehicles/two wheelers lubes segment and (b) end of bulk order

Financial summary (Standalone)

Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	10,087	11,286	12,121	13,333
Adj PAT (Rs mn)	1,003	1,211	1,502	1,654
Con. EPS* (Rs)	-	-	28.6	33.1
EPS (Rs)	20.2	24.4	30.3	33.4
Change YOY (%)	29.6	20.7	24.1	10.1
P/E (x)	42.7	35.4	28.5	25.9
RoE (%)	46.1	40.2	37.7	34.0
RoCE (%)	40.1	39.5	41.5	40.7
EV/E (x)	27.1	23.5	19.2	17.2
DPS (Rs)	7.0	8.5	10.6	13.3

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	FY17	FY18E	FY19E
Volumes (mn ltr)	84	90	99
Volume growth	11.0%	7.5%	10.0%
EBITDA margins	21.2	24.0	23.7

Price performance

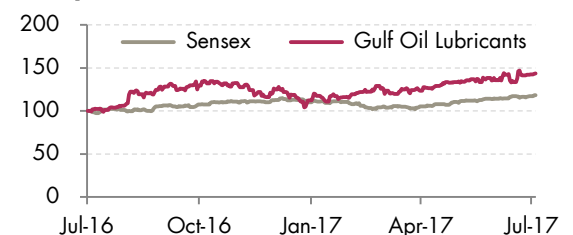


Exhibit 1: Results update (Rs mn)

(Rs. mn)	Quarter ended					12 months ended		
	Jun-17	Jun-16	% Chg	Mar-17	% Chg	FY18E	FY17	% Chg
Net Sales	2,800	2,727	2.7	2,989	(6.3)	12,121	11,286	7.4
Gross profit	1,018	839	21.4	1,067	(4.6)	5,343	4,578	16.7
EBIDTA	493	478	3.2	458	7.6	2,156	1,779	21.2
Other income	80	44	81.6	79	1.1	300	240	25.1
Depreciation	22	17	25.6	20	10.8	88	73	21.7
Interest	29	40	(27.6)	23	26.9	126	97	29.1
PBT	522	465	12.4	495	5.6	5,129	4,408	16.4
Tax	179	161	11.3	174	3.2	740	638	15.9
Reported PAT	343	304	12.9	321	6.8	1,502	1,211	24.1
No. of shares (mn)	50	50	-	50	0	50	50	-
Gross margin (%)	36.4	30.7	-	35.7	-	44.1	40.6	-
EBIDTA margin (%)	17.6	17.5	-	15.3	-	17.8	15.8	-
EPS - annualized (Rs.)	27.6	24.5	12.9	25.9	6.8	30.3	24.4	24.1

Source: Company, Axis Capital; * June '17 and June '16 financials are reported under Ind-AS

Analyst call highlight

- ◆ **Volumes:** Gulf Oil's core volumes grew 7% YoY in Q1FY18. Although Gulf reported double digit volume growth in Apr-May '17, GST-led destocking in June '17 impacted volume growth. The volumes are likely to recover from August '17 which will benefit Gulf's volumes in FY18
- ◆ **Chennai plant:** Investment till date stands at Rs 900 mn, with the remaining ~Rs 800-900 mn to be invested by Q3FY18. Gulf aims to start commercial operations from Q3FY18 with full utilization in Q4FY18. It has net cash of Rs 1.4 bn and aims to fund the expansion entirely from internal accrual only. Upon start, almost entire of Gulf's South India volumes (~30% of total) will switch to Chennai plant. However, benefits from freight cost savings will mostly get offset by higher fixed capital charges
- ◆ **Supply chain efficiencies to benefit from Q4FY18:** Gulf is currently doing a detailed study to optimize its supply chain to factor in (a) GST and (b) start-up of Chennai plant catering to ~30% of Gulf's volumes. The management expects that possible optimization of number of warehouses and size of depot will lead to positive benefit from Q4FY18

Financial summary (Standalone)

Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	10,087	11,286	12,121	13,333
Other operating income	-	-	-	-
Total operating income	10,087	11,286	12,121	13,333
Cost of goods sold	(5,509)	(5,943)	(6,383)	(7,022)
Gross profit	4,578	5,343	5,738	6,312
<i>Gross margin (%)</i>	<i>45.4</i>	<i>47.3</i>	<i>47.3</i>	<i>47.3</i>
Total operating expenses	(3,013)	(3,563)	(3,582)	(3,971)
EBITDA	1,565	1,779	2,156	2,340
<i>EBITDA margin (%)</i>	<i>15.5</i>	<i>15.8</i>	<i>17.8</i>	<i>17.6</i>
Depreciation	(60)	(73)	(88)	(151)
EBIT	1,504	1,707	2,067	2,189
Net interest	(178)	(97)	(126)	(107)
Other income	206	240	300	386
Profit before tax	1,533	1,849	2,242	2,468
Total taxation	(529)	(638)	(740)	(815)
<i>Tax rate (%)</i>	<i>34.5</i>	<i>34.5</i>	<i>33.0</i>	<i>33.0</i>
Profit after tax	1,003	1,211	1,502	1,654
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	1,003	1,211	1,502	1,654
<i>Adj. PAT margin (%)</i>	<i>9.9</i>	<i>10.7</i>	<i>12.4</i>	<i>12.4</i>
Net non-recurring items	-	-	-	-
Reported net profit	1,003	1,211	1,502	1,654

Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	99	99	99	99
Reserves & surplus	2,386	3,437	4,324	5,204
Net worth	2,485	3,537	4,424	5,303
Borrowing	1,953	1,801	1,551	1,301
Other non-current liabilities	33	45	45	45
Total liabilities	4,471	5,382	6,019	6,649
Gross fixed assets	1,474	1,941	3,263	3,296
Less: Depreciation	(405)	(478)	(566)	(717)
Net fixed assets	1,069	1,463	2,697	2,579
Add: Capital WIP	20	20	-	-
Total fixed assets	1,089	1,483	2,697	2,579
Total Investment	31	32	32	32
Inventory	1,569	1,499	398	365
Debtors	1,064	1,023	250	202
Cash & bank	2,351	2,891	3,111	3,909
Loans & advances	360	371	48	53
Current liabilities	2,015	1,931	531	504
Net current assets	3,351	3,868	3,291	4,039
Other non-current assets	-	-	-	-
Total assets	4,471	5,382	6,019	6,649

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	1,533	1,849	2,242	2,468
Depreciation & Amortisation	60	73	88	151
<i>Chg in working capital</i>	<i>244</i>	<i>23</i>	<i>797</i>	<i>49</i>
Cash flow from operations	1,254	1,539	2,388	1,854
<i>Capital expenditure</i>	<i>(165)</i>	<i>(467)</i>	<i>(1,302)</i>	<i>(33)</i>
Cash flow from investing	(165)	(467)	(1,302)	(33)
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>(209)</i>	<i>(152)</i>	<i>(250)</i>	<i>(250)</i>
<i>Dividend paid</i>	<i>(406)</i>	<i>(496)</i>	<i>(615)</i>	<i>(774)</i>
Cash flow from financing	(615)	(647)	(865)	(1,024)
Net chg in cash	474	425	220	797

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	20.2	24.4	30.3	33.4
CEPS (Rs)	21.5	25.9	32.1	36.4
DPS (Rs)	7.0	8.5	10.6	13.3
Dividend payout ratio (%)	34.6	35.0	35.0	40.0
GROWTH				
Net sales (%)	4.5	11.9	7.4	10.0
EBITDA (%)	23.0	13.7	21.2	8.6
Adj net profit (%)	29.6	20.7	24.1	10.1
FDEPS (%)	29.6	20.7	24.1	10.1
PERFORMANCE				
RoE (%)	46.1	40.2	37.7	34.0
RoCE (%)	40.1	39.5	41.5	40.7
EFFICIENCY				
Asset turnover (x)	4.7	5.0	4.6	4.8
Sales/ total assets (x)	1.7	1.6	1.7	1.9
Working capital/ sales (x)	0.1	0.1	-	-
Receivable days	38.5	33.1	7.5	5.5
Inventory days	67.2	57.6	14.6	12.1
Payable days	56.1	51.5	12.3	11.1
FINANCIAL STABILITY				
Total debt/ equity (x)	0.9	0.6	0.4	0.3
Net debt/ equity (x)	(0.2)	(0.4)	(0.4)	(0.5)
Current ratio (x)	2.7	3.0	7.2	9.0
Interest cover (x)	8.5	17.5	16.4	20.5
VALUATION				
PE (x)	42.7	35.4	28.5	25.9
EV/ EBITDA (x)	27.1	23.5	19.2	17.2
EV/ Net sales (x)	4.2	3.7	3.4	3.0
PB (x)	17.2	12.1	9.7	8.1
Dividend yield (%)	0.8	1.0	1.2	1.5
Free cash flow yield (%)	2.5	2.5	2.5	4.3

Source: Company, Axis Capital

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HOLD	Between 10% and -10%
SELL	Less than -10%

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