

Chevron Lubricants Lanka PLC (LLUB.N0000)

Blending for the nation

Chevron Lubricants Lanka PLC (LLUB), majority owned by Chevron Ceylon Limited (51.0%), is one of only two licensed blenders of lubricant products in Sri Lanka, and is the industry leader (55.0% volume market share in 2012). We expect LLUB's revenue to grow at a 5.3% CAGR over 2014E-2016E, and its EBITDA margin to improve 73bps to 29.5% in 2016E. Our modest growth forecasts are driven by market saturation and greater industry competition, which we believe will stem the growth in retail demand for automotive fuel (the largest segment of the industry). In addition, we believe that any meaningful margin expansion due to the mix-shift from mono- to multi-grade oils will be offset by higher depreciation expenses and an increase in LLUB's marketing spend (in order to slow its market share decline). However, LLUB's strong free cash flow (FCF) generation should support a stable dividend pay-out over our forecast period. Our DCF valuation, along with our relative valuation analysis, suggests a valuation range of LKR241-279, compared with the share price of LKR278 as of 24 February 2014.

LLUB's revenue to grow at a 5.3% CAGR through 2016E. We believe LLUB's top line will benefit from changing consumer dynamics in the retail automotive segment (currently accounts for roughly 70% of industry revenue). As GDP per capita and consumer awareness increase, we expect retail consumers to switch from using lower-tier mono-grade oils to higher-tier multi-grades, which should translate to revenue growth for the company. However, extended oil-drain intervals may result in volume growth slowing. We believe our revenue growth forecast could be exacerbated by intense rivalry within the industry. We have forecast LLUB's market share to decline to around 50.8% by 2016E from 2012 levels. This could be further threatened by the entry of additional operators into an already overcrowded market, as the government plans to issue more new licenses in the near future.

Modest EBITDA margin growth of 73bps over 2014E-2016E. We believe LLUB enjoys relatively higher margins compared to finished lubricant importers, due to its import tariff differential. In addition, we expect the industry mix-shift to multi-grade oils to support EBITDA margin expansion on the back of higher average selling prices (ASPs). However, we expect margins to be pressured owing to depreciation expenses resulting from the relocation to the Sapugaskanda (a suburb of Colombo) plant, which is expected to commence operations in June 2014. In addition, we believe LLUB may be compelled to increase its marketing expenditure if it is to stem its market share decline.

Strong FCF generation should support dividend payouts. LLUB's 2013 FCF came in at LKR1.4bn; since 2009, LLUB's FCF has averaged LKR1.7bn. We expect internal funding of the Sapugaskanda factory relocation (to be completed in June 2014) to reduce FCF further in 2014E, but believe that FCF will pick up again from 2015E. Strong FCF growth during our explicit forecast period (29.5% CAGR over 2014E-2016E) should support a dividend payout ratio of roughly 75% in 2014E, with this ratio increasing to 90% from 2015E onwards. In addition, we expect LLUB's zero-debt balance sheet to support future funding requirements, if needed.

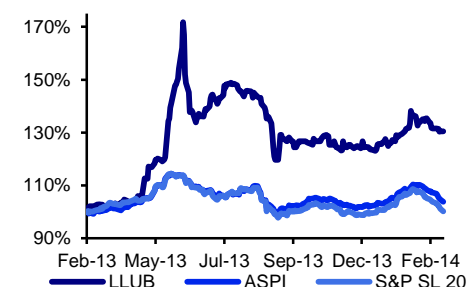
We establish a valuation range of LKR241-279. Our DCF analysis implies a valuation range of LKR242-279, inclusive of a potential upside and downside, as explained on page 13. Our P/E valuation suggests that LLUB currently trades at a 2014E P/E multiple of 12.0x – an 8.0% premium to the two-year historical forward P/E average. Inclusive of a 5% discount and a 5% premium to this two-year average, we establish a valuation range of LKR245-270. Our valuation methodology is discussed in detail on pages 12-15.

Key statistics

CSE/Bloomberg tickers	LLUB.N0000/LLUB SL
Share price (24 Feb 2014)	LKR278
No. of issued shares (m)	120
Market cap (USDm)	255
Enterprise value (USDm)	236
Free float (%)	49%
52-week range (H/L)	LKR366/213
Avg. daily vol. (shares,1yr)	63,450
Avg. daily turnover (USD '000)	139

Source: CSE, Bloomberg
Note: USD/LKR=129.7 (average for the one year ended 24 February 2014)

Share price movement



Source: CSE, Bloomberg

Share price performance

	3m	6m	12m
LLUB	5.3%	-7.3%	27.8%
S&P SL 20	0.8%	-4.0%	-0.4%
All Share Price Index	1.9%	-1.1%	2.6%

Source: CSE, Bloomberg

Summary financials

LKRm (year-end 31 December)	2013	2014E	2015E
Revenue	11,202	11,785	12,413
EBITDA	3,221	3,421	3,634
EBIT	3,175	3,314	3,522
Net profit	2,532	2,775	2,941
Recurrent EPS	21.10	23.12	24.51
ROE (%)	56.5	53.5	51.8
P/E (x)	12.7	12.0	11.3

Source: LLUB, Copal Amba estimates

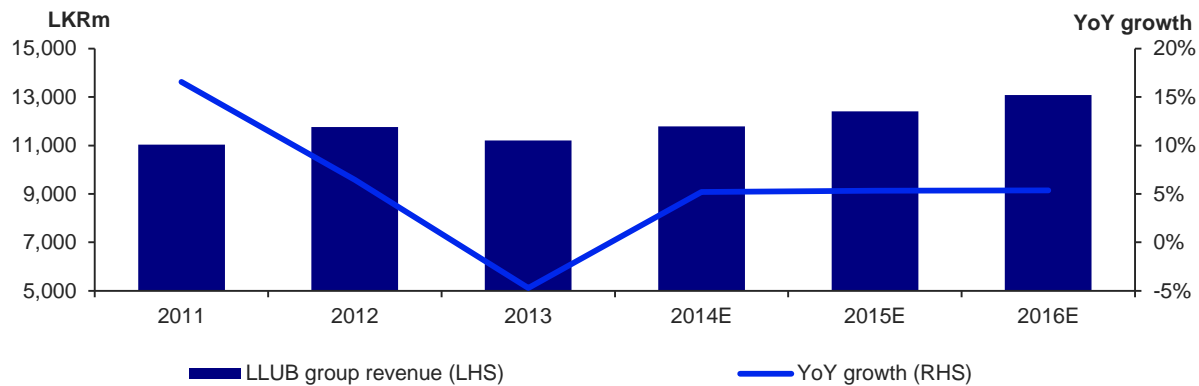
Table of Contents

LLUB to post a 5.3% revenue CAGR over 2014E-2016E	3
Automotive segment to remain the key driver of domestic revenue	3
Export revenue small yet stable.....	5
Industrials and other segment revenue to grow marginally by 1.6% over 2014E-2016E.....	5
Downside risks to revenue targets.....	5
EBITDA margin to widen a modest 73bps over 2014E-2016E.....	7
Downside risks to margin expansion	8
LLUB's solid FCF generation to support future dividend payout	10
Zero-debt balance sheet to support further financing needs	11
We establish a valuation range of LKR241-279 for LLUB's shares.....	12
DCF analysis yields a valuation range of LKR242-279 per share.....	12
P/E analysis yields a valuation range of LKR245-270 per share	14
EV/EBITDA analysis supports our P/E valuation with a range of LKR241-264	15
Relative valuation data used as a measure of comparison	16
Share price performance.....	18
Earnings release focus areas.....	19
Appendix 1: The Sri Lankan lubricant industry	20
History of the lubricant industry	20
The lubricant industry today.....	20
Appendix 2: Company overview.....	25
LLUB's business segments	25
Management strategy, transparency and governance.....	26
Shareholding structure	27
Board of directors	27
Appendix 3: SWOT analysis	28
Appendix 4: Key financial data.....	29
Summary group financials (LKRm).....	29
Key ratios.....	30
Fact sheet.....	31
Sri Lanka investment environment overview	31

LLUB to post a 5.3% revenue CAGR over 2014E-2016E

We expect LLUB to post a 5.3% revenue CAGR over 2014E-2016E (compared with a 6.6% CAGR over 2010-2013), driven largely by a 6.9% CAGR in the automotive segment, over the same period.

Figure 1: LLUB's revenue to grow at a 5.3% CAGR over 2014E-2016E



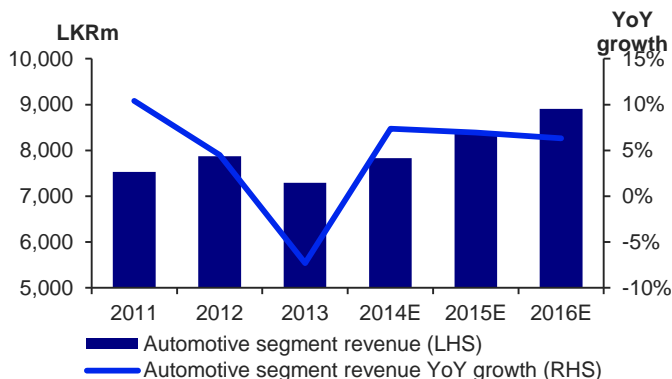
Source: LLUB, Copal Amba estimates

Automotive segment to remain the key driver of domestic revenue

We expect the increase in group revenue to be driven mainly by a 6.9% CAGR over 2014E-2016E in the automotive lubricants segment [which we believe accounted for approximately 65% of LLUB's revenue in 2013, based on our estimates using the Public Utilities Commission of Sri Lanka (PUCSL) industry breakdown]. This would be supported by an ASP CAGR of 4.5% during 2014E-2016E. We believe that annual new vehicle registrations should result in a 6.4% increase in Sri Lanka's total motor population through 2016E. However, we believe this would be offset by a 2.0% decline in lubricant consumption per vehicle over 2014E-2016E, in the wake of extended oil drain intervals due to the mix-shift toward multi-grade oil from mono-grade oils, thus slowing down volume growth in the lubricant industry.

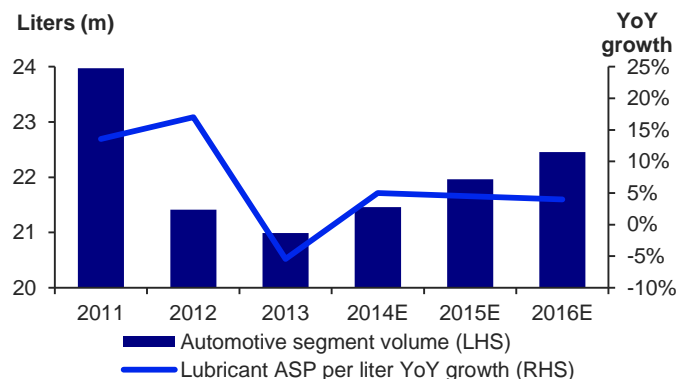
The domestic automotive segment to drive revenue supported by ASPs and new vehicle registration growth

Figure 2: Automotive segment revenue to grow at a 6.9% CAGR over 2014E-2016E



Source: LLUB, PUCSL, Copal Amba estimates

Figure 3: Automotive segment volumes to grow at a 2.3% CAGR over 2014E-2016E, with ASPs increasing at a 4.5% CAGR



Source: LLUB, PUCSL, Copal Amba estimates

We expect the demand for automotive lubricants in the retail sector to be driven largely by changing consumer dynamics in Sri Lanka. Growing affluence supported by higher GDP per capita,

together with rising consumer awareness about improved vehicle care, should boost segment revenue.

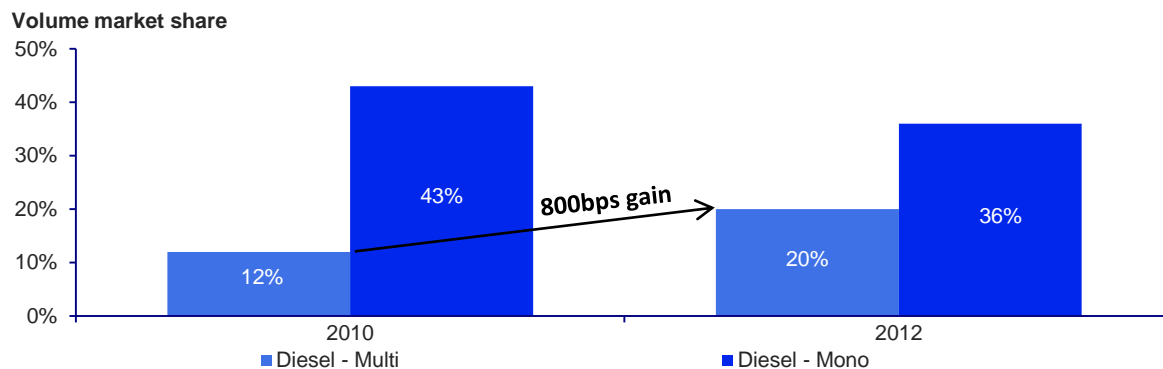
The Department of Motor Traffic of Sri Lanka has identified a rising trend of super luxury vehicle imports among new vehicle registrations (we consider new vehicles as those less than two years old). These statistics point toward greater affluence among the upper-middle class and the high-income class citizens in Sri Lanka.

As these newer vehicles are manufactured using the latest technology, they require better-quality lubricants to complement their new engines. Consumers are also becoming increasingly aware of vehicle maintenance best practices, and are hence opting for the more expensive multi-grade engine oils, as opposed to the mono-grade (lower-tier) oils. Higher-tier multi-grades provide the added benefit of longer oil drain intervals making the higher-tiers cost efficient, which also prompt consumers to switch over. Industry incumbents, together with regulatory bodies, have also been carrying out awareness programs in the recent past, which we believe are contributing to this change in consumer behavior. Additionally, original equipment manufacturers (OEMs) are now known to recommend their own-branded lubricants (multi-grade) for their vehicles, which should also support industry revenue growth.

Annual influx of new registered vehicles, together with greater awareness on vehicle care, should support the mix-shift from mono-grades to multi-grades, resulting in revenue growth

Furthermore, we note that the number of larger commercial diesel vehicles (the diesel segment under the total vehicle segment accounts for a 56% volume market share of the automotive lubricant industry) switching over to multi-grade oils has seen a noteworthy increase from 2010, largely due to the extended oil drain intervals, versus petrol-based vehicles (see Figure 30). Direct costs and opportunity costs of servicing buses and lorries are reduced when using multi-grades as the vehicles spend less time in service stations.

Figure 4: Diesel multi-grades have seen significant growth since 2010 and accounted for 20% of the lubricant volume sold by 2012



Source: PUCSL

These trends should lead to higher ASPs for LLUB as multi-grade oils are priced roughly 75-80% more than mono-grades. However, since the replacement times are longer, we expect industry volume growth to slow down over our explicit forecast period. In addition, LLUB is facing intense competition in the industry, which has resulted in it losing market share rapidly over the past four years (market share fell to 55.0% in 2012 from 78.0% in 2008). Therefore, we expect LLUB's market share to fall further by 430bps to reach 50.8% in 2016E due to the current industry rivalry as well as the entry of new players to the industry in the near future (timeframe yet unknown) on the back of more licenses being issued to sell lubricants in Sri Lanka.

Extensive distribution network and brand strength should support top-line growth

LLUB was the first lubricant operator to hold exclusive rights for distribution in Sri Lanka, which it leveraged by setting up its own-branded distribution network that consists of its own-branded distribution outlets (Oil Marts) spread across the country. LLUB currently has over 650 distribution outlets through which it markets its main brands. Its Caltex brand and logo are well known and we

believe this should help push sales through. In addition, lubricant blenders enjoy a raw material import tariff differential of around 20% over finished lubricant importers (according to the PUCSL), which should allow for better pricing.

Import tariff differential of 20% supports better pricing for the domestic lubricant blenders

Export revenue small yet stable

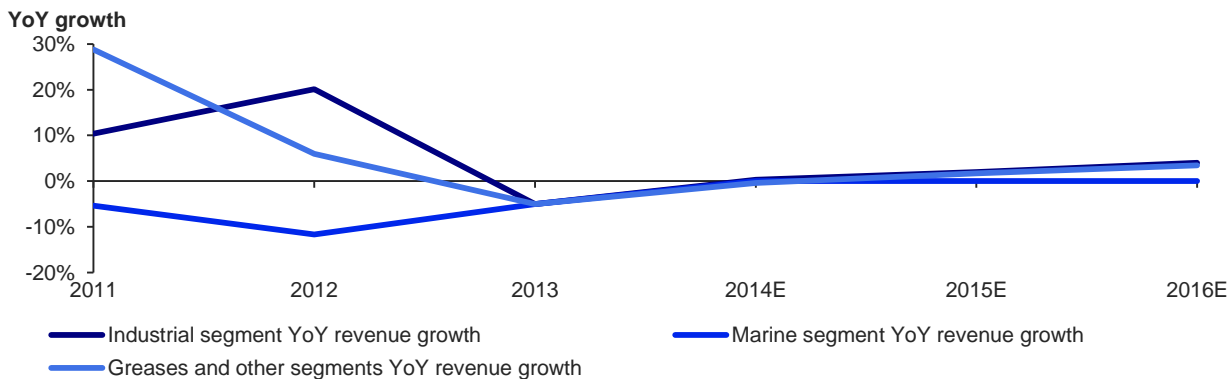
LLUB's export exposure is primarily to Bangladesh and the Maldives. This segment accounts for just 6% of group revenue, and we expect this mix to be maintained. We expect this segment to continue its contribution to group revenue and forecast a 4.3% export revenue CAGR over 2014E-2016E (compared with a 21.2% CAGR over 2012-2013, when the export business was first established), off a small base. This estimate is based on the assumption that its present export operations will continue at their current pace throughout our explicit forecast period, as the company has not confirmed any plans to expand its presence into new markets.

We expect export operations to continue at its present levels throughout the foreseeable future, in the absence of specific company guidance

Industrials and other segment revenue to grow marginally by 1.6% over 2014E-2016E

These segments – whose growth is largely driven by demand from a variety of sectors, such as agriculture and fisheries, thermal power generation, transport and construction, and rubber – account for the remainder of domestic revenue (27% of 2013 group revenue). We believe the revenue-generating capacity from these segments is difficult to measure due to the lack of available information and the complexities involved in forecasting the impacts of the various macroeconomic variables that affect these industries (such as weather conditions and global crude oil prices). Therefore, we forecast slight revenue growth over our explicit forecast period (compared with a 8.9% revenue CAGR over 2010-2013).

Figure 5: Other domestic revenue to increase by 1.6% through 2016E

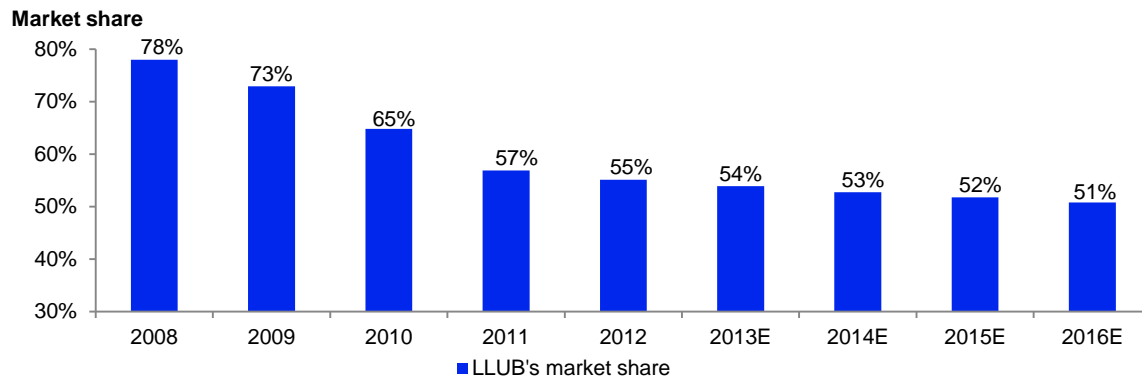


Source: LLUB, Copal Amba estimates

Downside risks to revenue targets

- **Greater competition.** Although customers are switching to higher-grade oils, the mix-shift has been a very gradual one, with mono-grades still accounting for over 50% of the total automotive industry volume. Furthermore, existing players are also competing on multi-grades, which exerts further pressure on LLUB's competitive advantage. With the PUCSL likely to liberalize the market further, rivalry in the industry is expected to intensify.
- **Market saturation.** The lubricant market in Sri Lanka appears to be close to saturation point, evident by the gradual decline in the volume of locally blended lubricants and finished lubricants imported for resale into the country. This implies limited growth potential for incumbents, including LLUB, who run the risk of losing market share even further.

Figure 6: LLUB's market share is at risk of declining more than anticipated



Source: PUCSL, Copal Amba estimates

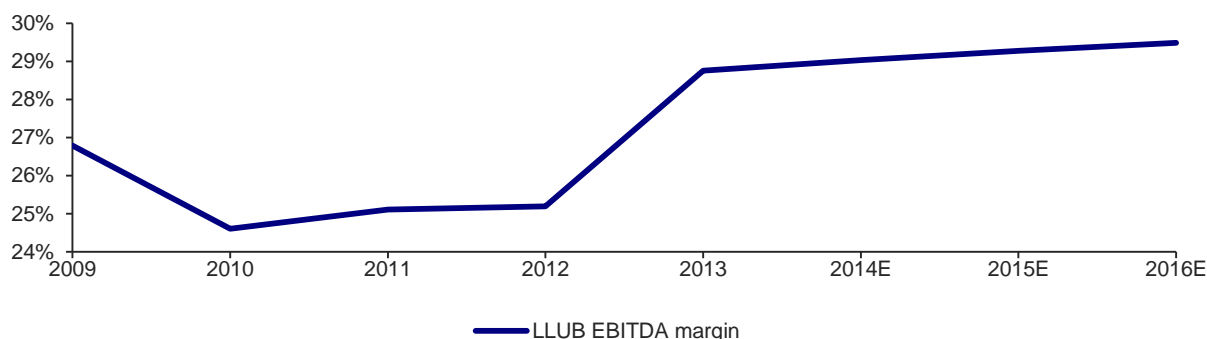
- Erosion of distribution strength.** LLUB's retail lubricants are primarily sold through its own Oil Marts. However, the bulk of retail lubricant sales take place through service stations directly, as most consumers tend to purchase engine oils and other lubricants at the point of servicing their vehicles. Most of these customers also rely on the service station's recommendations, which are often based on the mark-up these stations earn on wholesale purchases from different lubricant sellers. Lubricant sellers offering higher mark-ups to the service stations tend to be preferred over other brands. Should competitors offer better prices to distributors, LLUB could lose out.
- Impact of adulterated products.** Product adulteration refers to the practice of mixing cheap solvents with original products purchased from licensed players and selling them under the same brand or as own-branded products, and also includes the reselling of filtered used oils mixed with cheaper solvents. According to PUCSL statistics, this market accounts for approximately 5% of the total industry. While LLUB, together with other licensed players, has carried out numerous awareness campaigns highlighting the dangers of using adulterated products in vehicles, the absence of local laboratory facilities to check the quality of imported lubricant products means that most adulterated products are circulated without much restriction.
- Higher tariffs on imported vehicles.** If the government of Sri Lanka (GoSL) was to increase the excise duty on imported vehicles further, it could lead to a decline in new vehicle registrations, which, in turn, could have a direct impact on lubricant companies in Sri Lanka.

Higher competition and market saturation present the greatest downside risks to revenue growth

EBITDA margin to widen a modest 73bps over 2014E-2016E

We forecast LLUB's EBITDA margin to improve by 73bps to reach 29.5% in 2016E from 28.8% in 2013, supported by higher ASPs; however, we believe these benefits may be offset by higher depreciation and operating expenses.

Figure 7: LLUB's EBITDA margin to expand by 73bps through 2016E



Source: LLUB, Copal Amba estimates

As a result of the shift toward higher-tier oils, much of the margin growth in the automotive lubricant industry has stemmed from higher ASPs. Segment ASPs have increased at a 7.0% CAGR over 2010-2013 and we expect this trend to continue. We believe that LLUB is set to benefit from this trend, particularly as the company focuses primarily on multi-grade oils, and also as it benefits from a significant tariff differential over finished lubricant importers, which allows it to price its products more competitively. This, together with the economies of scale earned through LLUB's volume of operation, should contribute toward margin growth.

Higher industry ASPs and the benefit of the import tariff differential enjoyed by blenders, together with economies of scale, should drive LLUB's tepid EBITDA margin growth

Figure 8: Retail price differential (LKR/liter) between mono- and multi-grade lubricants

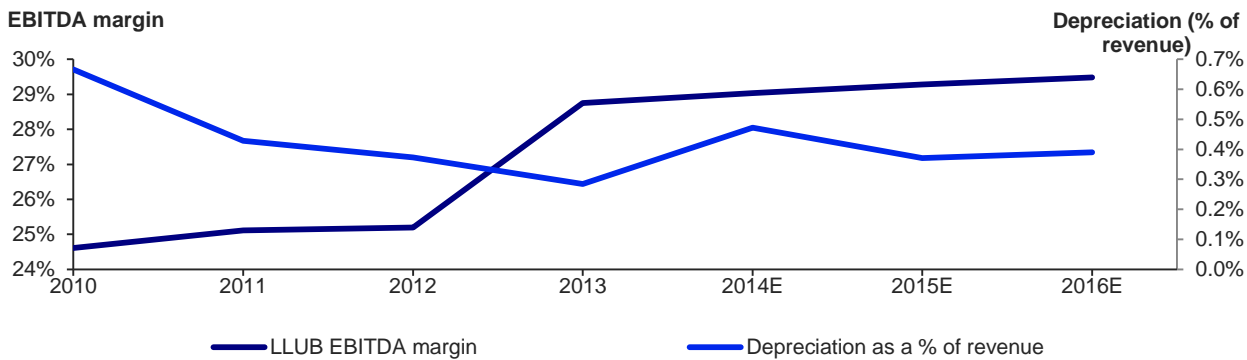
Lubricant brand	Multi-grade	Mono-grade	Premium
Chevron Super Plus	553	400	38%
Chevron – Havoline	770	NA	NA
Lanka IOC	534	388	37%
Laugfs	648	399	62%
Mobil	898	NA	NA
Toyota	1,036	NA	NA
Ceylon Petroleum Corporation (CPC)	529	390	36%
Sinopec	NA	361	NA

Source: LLUB, PUCSL, Copal Amba estimates

However, we believe that the benefits earned through higher ASPs would likely be offset by higher direct costs and other operating expenses on account of the following factors:

Higher depreciation costs. Due to the new plant at Sapugaskanda (a suburb of Colombo) to be commissioned in June 2014 (refer to Appendix 2), LLUB's annual depreciation expense is expected to double over our explicit forecast period. As we believe LLUB accounts for two-thirds of its depreciation under COGS, this would directly impact EBITDA margin expansion.

Figure 9: EBITDA margin increases when depreciation costs (as a % of revenue) decline



Source: LLUB, Copal Amba estimates

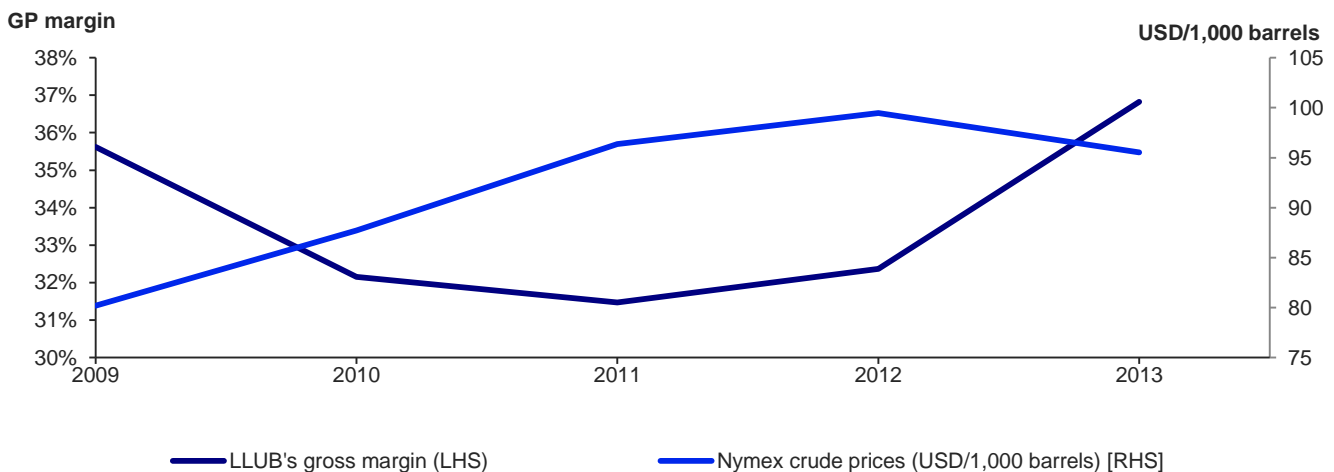
Increase in marketing spend. We believe LLUB will be compelled to increase its investment in marketing and promotions (SG&A) as a proportion of sales in order to face the intense competition prevalent in the industry and to stem its market share decline going forward. These incremental expenses may slow any meaningful EBITDA margin expansion.

Higher depreciation expenses (included in COGS) and increased marketing spend to offset margin growth

Downside risks to margin expansion

- **Rise in base oil prices.** Base oil prices are linked to global crude oil prices. Although management states that LLUB is somewhat cushioned against increases in global oil prices as it purchases all of its base oil requirements from its parent company, thereby enjoying purchasing synergies, we believe that global crude oil price fluctuations could affect LLUB's margins. Figure 10 depicts that LLUB's gross margins are negatively correlated with global crude oil prices, falling when oil prices rise, and increasing when oil prices reduce.

Figure 10: LLUB's GP margin is negatively correlated against global crude oil prices



Source: LLUB, PUCSL, Copal Amba estimates

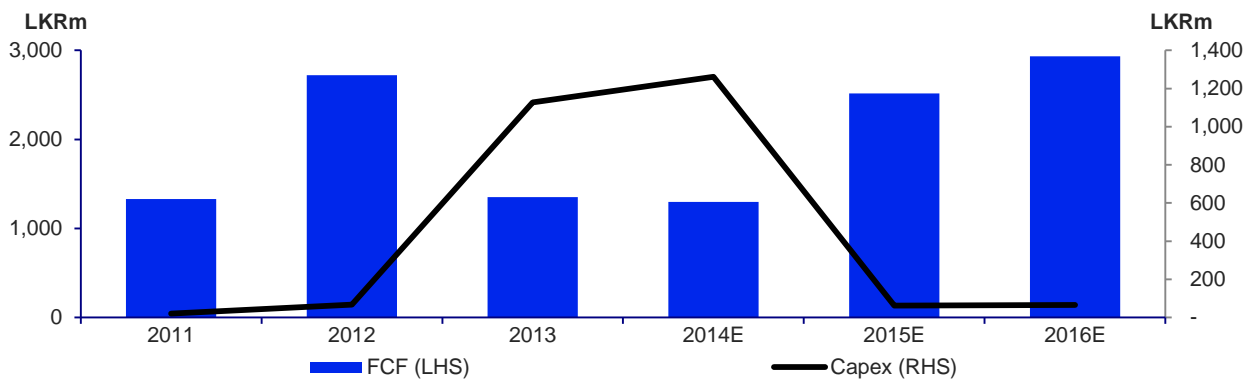
- **Regulatory changes to the tariff advantage.** Information obtained from the PUCSL indicates that finished lubricant importers are heavily lobbying against the tariff advantage enjoyed by the two licensed blenders (LLUB and Lanka IOC), as they believe that it provides an undue advantage. Hence, we do not rule out the possibility of an import duty/cess revision that could potentially bridge this gap. Any move to bring down the cess or the customs duty on the import of finished lubricants may directly increase the ability of importers to undercut prices further. On the other hand, any upward revision on the customs duty or cess on base-oils would put LLUB's margins under pressure.
- **FX fluctuations and its impact on margins.** As LLUB imports its base oil requirements from its parent, it is likely to be vulnerable to the impact of changes in the forex rate. A weakening Sri Lankan rupee would mean LLUB has to spend more to buy its supplies. This could increase costs and restrict margin expansion.
- **Increase in operational expenses.** An increase in other key operational expenses, such as electricity and distribution costs, could also negatively impact LLUB's EBITDA margin.

LLUB's solid FCF generation to support future dividend payout

LLUB has historically maintained a sound FCF, averaging LKR1.7bn over 2009-2013. FCF came in at LKR1.4bn during 2013, and we believe this will go down further in 2014E on account of the Sapugaskanda factory relocation anticipated to be completed by June 2014. This project will cost an estimated USD15m (LKR2.0bn), which we believe should be split roughly equally over 2013 and 2014E. LLUB has financed this project entirely using internal funds, which confirms the company's solid liquidity position. We believe FCF will rebound to above LKR2.5bn from 2015E onwards, and expect FCF to grow at a 29.5% CAGR 2014E-2016E, compared with just 8.0% over 2011-2013.

LLUB's FCF to grow at a 29.0% CAGR over 2014E-2016E, despite capex being financed internally

Figure 11: FCF generation to remain healthy despite LKR2.0bn capex outflow over 2013-2014E

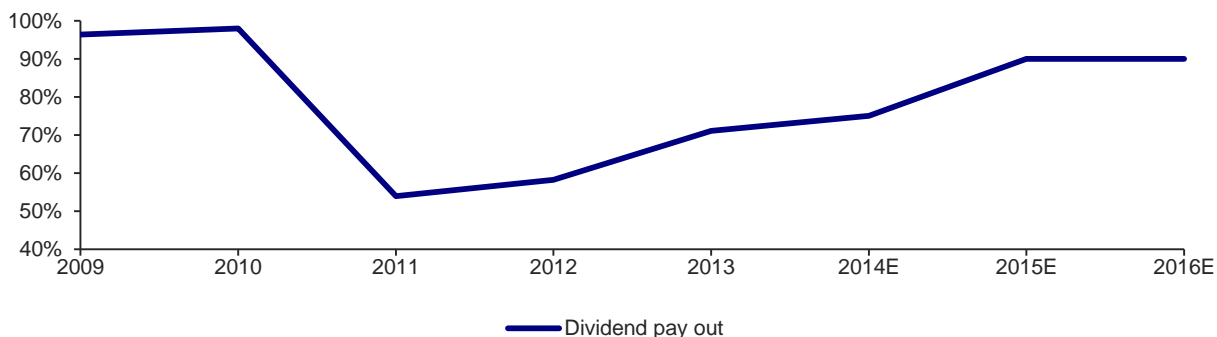


Source: LLUB, Copal Amba estimates

LLUB's strong FCF generation means that equity holders are set to benefit through stable dividend pay-outs over the long term. Before commissioning the new plant, LLUB's dividend payout was almost 100% as shown in Figure 12. We expect the dividend pay-out to shift back to 90% from 2015E onwards, once the new plant is commissioned.

Dividend payout to shift back to 90%-levels from 2015E onwards

Figure 12: Strong FCF generation to contribute towards stable dividend payouts through 2016E



Source: LLUB, Copal Amba estimates

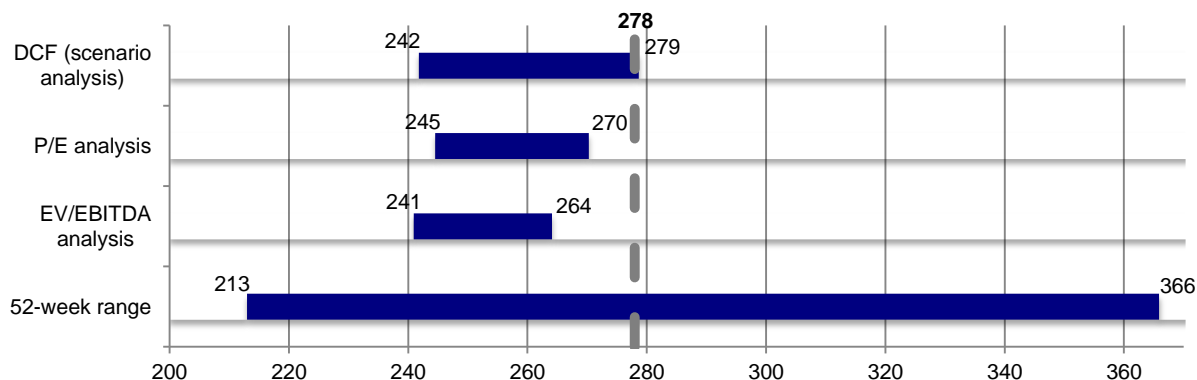
Zero-debt balance sheet to support further financing needs

LLUB's all-equity-financed balance sheet puts the company in a position to easily finance any further expansions, should the company choose to do so. We believe, however, that its zero-debt position will continue into the foreseeable future. This means that LLUB could easily consider a combination of internally generated funds and external debt funding (with debt easier to obtain, at attractive rates), should the need arise.

We establish a valuation range of LKR241-279 for LLUB's shares

We establish a 12-month valuation range of LKR241-279 per share, based on our current earnings outlook for LLUB shares, compared with the current share price of LKR278 as of 24 February 2014. We arrive at our valuation range by applying scenario analysis to a DCF valuation, and using P/E and EV/EBITDA-based relative valuation approaches. For comparison, we also assess LLUB's valuation levels relative to a group of peers.

Figure 13: Valuation range analysis provides a range of LKR241-279 per share (current share price: LKR278)



Source: LLUB, Bloomberg, Copal Amba estimates

DCF analysis yields a valuation range of LKR242-279 per share

In valuing LLUB shares, we applied a DCF approach. Our base-case assumptions of a risk-free rate of 9.0% and a market risk premium of 6.0% yield a value per share of LKR251. Adjusting these assumptions (to allow for bull- and bear-case scenarios) implies a valuation range of LKR242-279.

Our base-case assumptions include a risk-free rate of 9.0% and a market risk premium of 6.0%

Other elements of our valuation approach include the following:

- LLUB's current capital structure is 100% equity based. We have assumed a 15% debt and 85% equity target capital structure.
- Our base-case valuation assumes a terminal growth of 2.0%.

Figure 14 reflects our DCF assumptions for LLUB. We have estimated the following:

- EBIT and FCF figures throughout the explicit and fade periods.
- Terminal value at 2022E, calculated by applying a terminal growth rate to unleveraged FCF, as of 2022E.

Finally, we arrived at our group equity value by discounting the unleveraged FCF values over the explicit and fade periods at the WACC.

Figure 14: Amba DCF assumptions schedule (base case)

WACC assumptions		2014E	
Target capital structure (debt/equity)	15/85	EBIT total (1-t)	2,486
Cost of equity	13.8%	FCF	1,159
Cost of debt	10.0%	Terminal value (undiscounted)	38,821
Growth rate	2.0%	Equity value	30,123
WACC	12.9%		

Source: Copal Amba estimates

Note: All figures are in LKRm unless otherwise stated

Taking into consideration the factors that can yield an upside (discussed below) and downside risks discussed on pages 5 and 8, we arrive at bull- and bear-case scenarios (shown in Figure 15) to establish our valuation range of LKR242-279. These assumptions yield the following scenarios:

- **Bull-case scenario:** Here, we assume that LLUB performs better than our estimates and achieves a 0.5% increase in volume market share each year, over and above our base-case assumptions. This scenario also assumes ASPs to be 0.5% higher than base-case YoY growth rates. This leads to revenue growth of 6.2% YoY in 2014E (compared to the base-case YoY growth rate of 5.2% in 2014E) and translates to a 5.9% revenue CAGR over 2014E-2016E (versus our base-case estimate of 5.3%). Here, we also assume a 0.25% expansion (above our base-case estimate) in the group EBITDA margin, leading to a 98bps increase through 2016E (compared to our base-case estimate of 73bps over the same period).
- **Bear-case scenario:** Here, the potential downside assumes a 0.5% decline in volume market share annually and a 0.5% decline in ASPs compared to our base-case estimates. This results in a YoY revenue growth rate of 4.2% in 2014E (compared to the base-case YoY growth rate of 5.2%) and a 4.7% revenue CAGR over 2014E-2016E (compared to our base-case estimate of 5.3%). Here, we also assume a 0.25% contraction in the EBITDA margin (below our base-case estimates) at group level, resulting in a 48bps increase through 2016E (compared to our base-case estimate of 73bps over the same period).

Scenario analysis driven by changes in volume market share, ASPs and EBITDA margin assumptions

Figure 15: LLUB scenario analysis assumptions

	2013	Base-case			Bull-case			Bear-case		
		2014E	2015E	2016E	2014E	2015E	2016E	2014E	2015E	2016E
Segment revenue										
Automotive revenue	7,292	7,829	8,373	8,903	7,941	8,535	9,120	7,718	8,213	8,689
YoY growth	-7.3%	7.4%	7.0%	6.3%	8.9%	7.5%	6.9%	5.8%	6.4%	5.8%
Automotive ASPs per liter	347	365	381	396	367	385	402	363	378	391
YoY growth	-5.5%	5.0%	4.5%	4.0%	5.5%	5.0%	4.5%	4.5%	4.0%	3.5%
Industrials and other revenue	3,053	3,056	3,105	3,204	3,056	3,105	3,204	3,056	3,105	3,204
YoY growth	-5.0%	0.1%	1.6%	3.2%	0.1%	1.6%	3.2%	0.1%	1.6%	3.2%
LLUB's volume market share										
	53.9%	52.8%	51.8%	50.8%	53.3%	52.3%	51.3%	52.3%	51.3%	50.3%
LLUB group										
LLUB revenue	11,202	11,785	12,413	13,079	11,896	12,575	13,297	11,673	12,254	12,866
YoY growth	-4.7%	5.2%	5.3%	5.4%	6.2%	5.7%	5.7%	4.2%	5.0%	5.0%
LLUB EBITDA margin	28.8%	29.0%	29.3%	29.5%	29.3%	29.5%	29.7%	28.8%	29.0%	29.2%

Source: LLUB, Copal Amba estimates

P/E analysis yields a valuation range of LKR245-270 per share

LLUB's 12-month forward P/E has ranged from 7.9x to 16.7x since January 2011. The share's two-year average historical forward P/E multiple stands at 11.1x. The stock currently trades at a 2014E multiple of 12.0x (based on our forecasts) – an 8.0% premium to its two-year historical average.

Figure 16: LLUB has traded at a P/E of between 7.9x and 16.7x over the past three years



Source: LLUB, Bloomberg

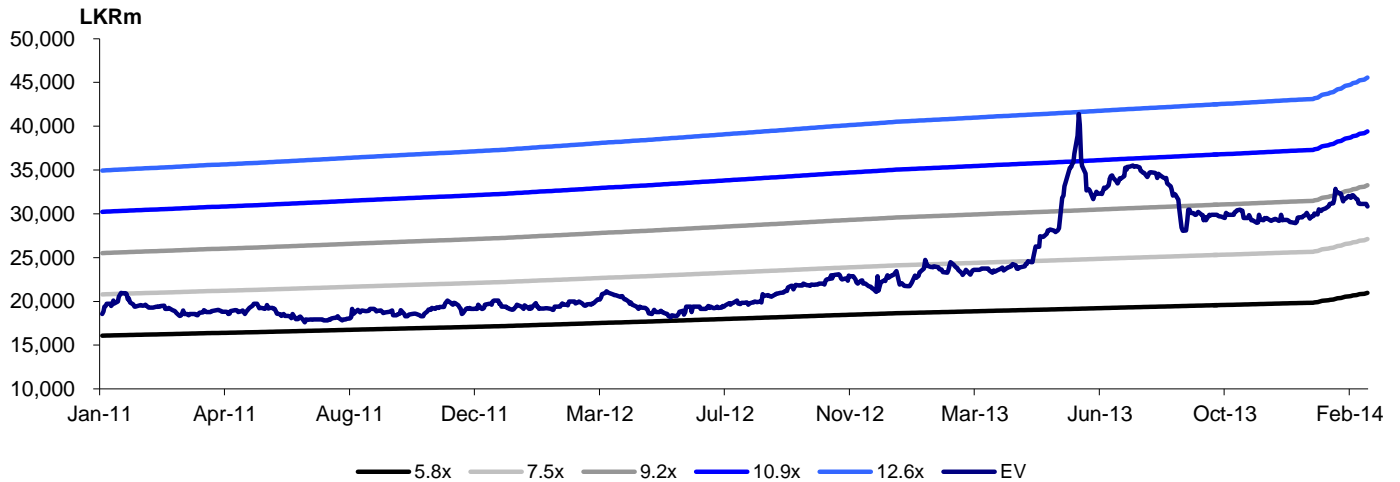
In determining a P/E valuation range, we apply two scenarios:

- **Optimistic scenario:** Under this scenario, we assume that LLUB will be able to stem its margin decline; we also assume a lower-than-expected market share decline, a higher-than-forecast increase in vehicle registrations and greater export exposure. We applied a 5% premium to the two-year historical P/E average and arrived at a forward multiple of 11.7x. Applied to our forecast 2014E EPS estimate of LKR23.1, this leads to a share price of LKR270 per share.
- **Pessimistic scenario:** Here, we assume a 5% discount to the two-year historical average, implying that LLUB will trade at a forward multiple of 10.6x. This could be driven mainly by higher-than-forecast declines in market share (volume) and a higher-than-anticipated increase in direct and other operating costs, which could weigh down on the EBITDA margin. Applying this multiple to our 2014E EPS estimate, we arrive at a fair value of LKR245 per share.

EV/EBITDA analysis supports our P/E valuation with a range of LKR241-264

On an EV/EBITDA basis, LLUB currently trades at a 2014E multiple of 9.0x, a 10.7% premium to its two-year historical average. Applying a 5% upside and 5% downside (warranted by upside and downside risks, as discussed earlier) to the two-year historical average, we arrive at a range of LKR241-264.

Figure 17: LLUB has traded at an EV/EBITDA of between 5.8x and 12.6x over the past three years



Source: LLUB, Bloomberg

Relative valuation data used as a measure of comparison

Figures 18 and 19 present LLUB's valuation metrics relative to its peers. LLUB trades at a 17.7% discount to the average of its peers based on P/E valuation metrics. The share trades at a 2014E P/E of 12.0x, compared with the peer group average of 14.6x.

Figure 18: On a P/E basis, LLUB trades at a 17.7% discount to its regional peer average

Company name	P/E				EPS CAGR	FCF yield	
	2012	2013	2014E	2015E	2014E-2015E	2012	2013
Chevron Lubricants Lanka PLC	14.2x	12.7x	12.0x	11.3x	7.8%	8.5%	4.2%
Lanka IOC PLC	11.4x	3.7x	4.3x	4.5x	22.5%	13.2%	12.7%
PetroNas Dagangan Bhd	27.9x	38.5x	30.1x	26.3x	18.9%	6.0%	2.8%
Bharat Petroleum Corp Ltd	32.4x	14.5x	12.4x	11.6x	10.0%	-14.7%	-5.0%
YunNan Yuntianhua Co Ltd	NA	32.3x	28.5x	24.2x	15.5%	-12.6%	NA
Esso Thailand PCL	NA	10.9x	8.8x	10.3x	2.9%	24.6%	NA
MJL Bangladesh Ltd	29.2x	23.6x	18.1x	13.4x	32.6%	0.1%	NA
Kwantas Corp Bhd	18.4x	13.6x	12.0x	9.8x	NM	0.7%	11.6%
Phoenix Petroleum Philippines	14.3x	NA	6.1x	4.9x	NM	-56.9%	NA
Ahmad Zaki Resources Bhd	10.1x	22.2x	11.1x	6.0x	87.1%	-23.1%	NA
Mean	20.5x	19.9x	14.6x	12.3x	27.1%	-0.7%	5.5%
Median	18.4x	18.4x	12.0x	10.3x	18.9%	0.4%	7.2%
High	32.4x	38.5x	30.1x	26.3x	87.1%	24.6%	12.7%
Low	10.1x	3.7x	4.3x	4.5x	2.9%	-23.1%	-5.0%

Source: LLUB, Bloomberg, Copal Amba estimates

Note: Ratios above 50% have been considered as outliers. Lanka IOC PLC and Bharat Petroleum Corp Ltd have their financial year ends on 31 March, while Kwantas Corp Bhd has its financial year on 30 June.

The only listed domestic peer, Lanka IOC PLC (LIOC), is the other licensed lubricant blender in Sri Lanka, while the other players are spread across the South Asian and Southeast Asian regions. However, while the companies in the peer set are not a perfect match, they provide some measure of comparison with LLUB.

Figure 19: LLUB trades at an EV/EBITDA of 9.0x 2014E, a 9.7% discount to its peer average

Company name	EV/EBITDA				EBITDA CAGR
	2012	2013	2014E	2015E	2014E-2015E
Chevron Lubricants Lanka PLC	10.0x	9.2x	9.0x	8.5x	6.2%
Lanka IOC PLC	6.1x	4.0x	NA	NA	NM
PetroNas Dagangan Bhd	16.0x	22.3x	19.2x	18.1x	9.6%
Bharat Petroleum Corp Ltd	7.6x	6.7x	7.7x	7.5x	-6.6%
YunNan Yuntianhua Co Ltd	24.7x	NA	NA	NA	NM
Esso Thailand PCL	25.2x	7.6x	7.0x	7.8x	-1.6%
MJL Bangladesh Ltd	16.3x	16.0x	11.4x	8.2x	39.3%
Kwantas Corp Bhd	11.9x	10.5x	9.9x	8.8x	12.4%
Phoenix Petroleum Philippines	11.8x	NA	7.1x	6.0x	NM
Ahmad Zaki Resources Bhd	4.0x	11.4x	7.5x	4.2x	64.2%
Mean	13.7x	11.2x	10.0x	8.7x	10.6%
Median	11.9x	10.5x	7.7x	7.8x	9.6%
High	25.2x	22.3x	19.2x	18.1x	39.3%
Low	4.0x	4.0x	7.0x	4.2x	-6.6%

Source: LLUB, Bloomberg, Copal Amba estimates

Note: Ratios above 50% have been considered as outliers Lanka IOC PLC and Bharat Petroleum Corp Ltd have their financial year ends on 31 March, while Kwantas Corp Bhd has its financial year end on 30 June.

Since LLUB has a high dividend pay-out ratio, we have taken two local companies that are listed on the S&P SL 20 Index with similar dividend policies, for comparison in Figure 20 below:

Figure 20: LLUB's dividend yield in comparison to other strong dividend-paying companies on the S&P SL 20 Index

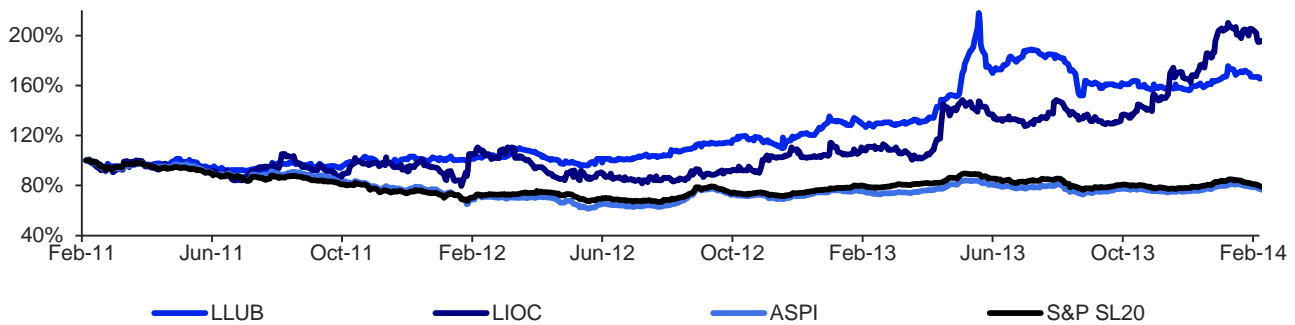
Company name	Dividend yield					Dividend payout				
	2012	2013	2014E	2015E	2016E	2012	2013	2014E	2015E	2016E
Chevron Lubricants PLC (LLUB)	4.1%	5.6%	6.3%	8.0%	8.6%	58%	71%	75%	90%	90%
Ceylon Tobacco Company PLC (CTC)	5.6%	4.1%	4.8%	5.3%	5.7%	104%	100%	97%	97%	97%
Nestle Lanka PLC (NEST)	3.4%	2.9%	3.4%	3.8%	4.2%	99%	98%	98%	98%	98%

Source: LLUB, NEST, CTC, Bloomberg, Copal Amba estimates

Share price performance

LLUB shares closed at LKR278 on 24 February 2014, LKR61 higher than 12 months earlier, an increase of 27.8%, compared to a 0.4% decrease in the S&P SL 20, a 2.6% increase in the All Share Price Index (ASPI) and a 75.8% increase in LIOC over the period.

Figure 21: LLUB has outperformed the market over the past 12 months, but has underperformed its closest competitor LIOC



Source: CSE, Bloomberg

As shown in Figure 22, over the past three years, LLUB has outperformed the CSE's two main indices. However, the company has consistently underperformed its closest domestic rival, LIOC.

Figure 22: LLUB vs. key indices

	3m	6m	1 year	2 years	3 years
LLUB	5.3%	-7.3%	27.8%	61.6%	65.7%
LIOC	30.2%	37.4%	75.8%	76.7%	95.3%
S&P SL 20	0.8%	-4.0%	-0.4%	7.6%	-21.5%
ASPI	1.9%	-1.1%	2.6%	5.7%	-23.7%

Source: CSE, Bloomberg

Earnings release focus areas

Here is a checklist of items that investors should track in the next – and subsequent – quarterly earnings release. We will closely track LLUB's performance across these key areas, and will revise our forecasts and update our valuation range in future earnings update notes.

1. Has the PUCSL issued any new licenses, particularly for blending?
2. Have there been any changes to the tariff advantage enjoyed by the licensed blenders?
3. Has LLUB's market share moved?
4. Has there been any significant increase in base oil import prices or import prices of finished lubricants?
5. Has there been any increase in the industry share of adulterated products?
6. Has LLUB increased its export footprint?
7. Is the relocation to the Sapugaskanda plant on schedule?

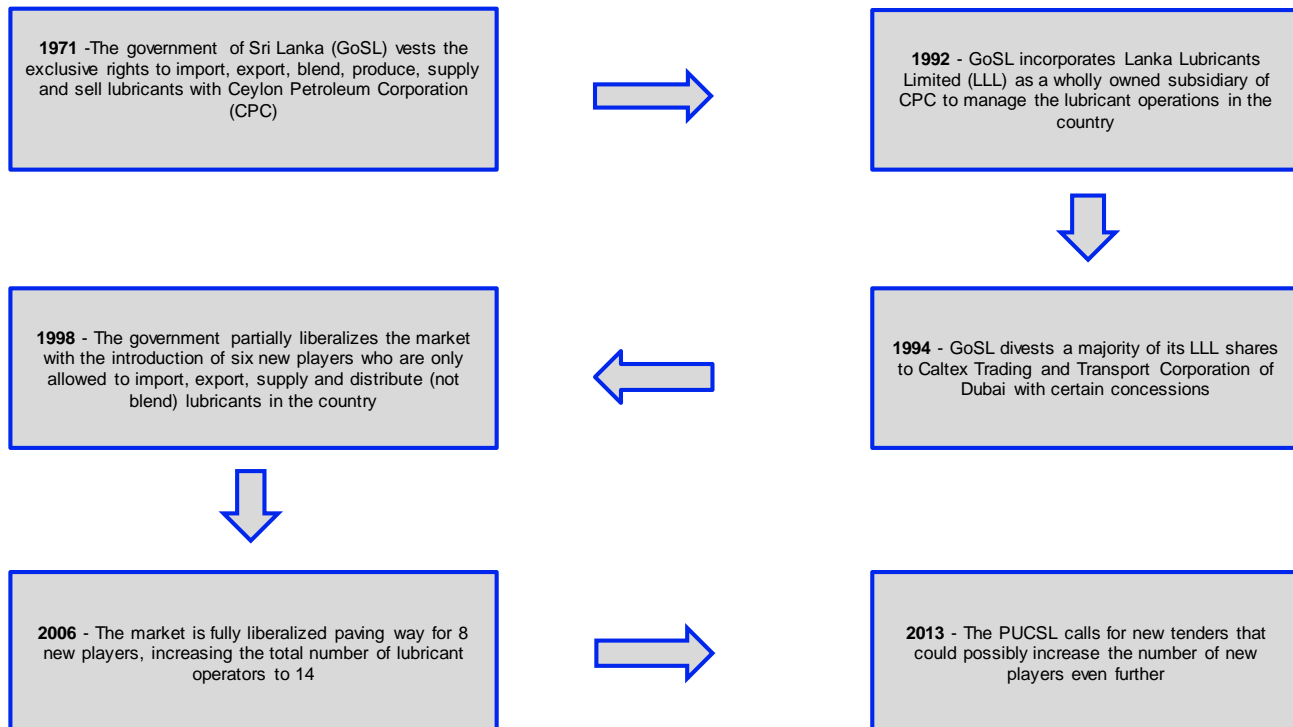
Appendix 1: The Sri Lankan lubricant industry

History of the lubricant industry

The Sri Lankan lubricant market started out as a monopoly in 1971, when the government of Sri Lanka (GoSL) conferred exclusive rights to Ceylon Petroleum Corporation (CPC) to import, export, blend, produce, supply and sell lubricants in the country. In 1992, the GoSL incorporated Lanka Lubricants Limited (LLL) as a wholly owned subsidiary of CPC to manage lubricant operations in Sri Lanka. Subsequently, in 1994, the GoSL divested a majority of its shares in LLL to Dubai-based Caltex Trading and Transport Corporation, thus creating Chevron Lubricants Lanka PLC (LLUB).

However, LLUB lost its monopoly status four years later, when the GoSL partially liberalized the lubricant industry in 1998, bringing in a total of six industry-licensed operators (who were only allowed to import, export, supply and distribute, but not blend lubricants). In 2006, the market was fully liberalized, with 8 new licensed players allowed to enter, bringing the total number of operators to 14.

Figure 23: Timelines of industry evolution

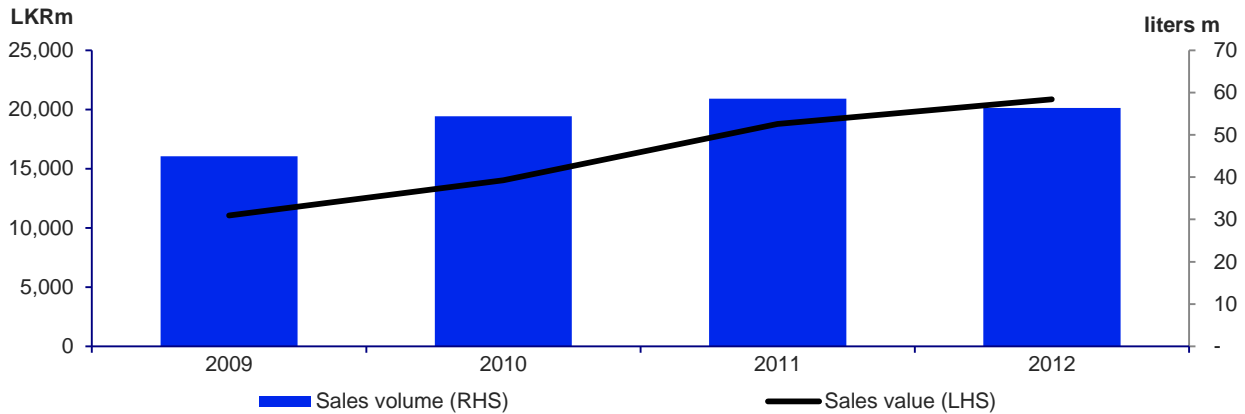


Source: Lubricant Market Report (2009), PUCSL

The lubricant industry today

As of 2012, the Sri Lankan lubricant industry was worth LKR21bn (USD163m), comprising 13 licensed operators, who collectively produced 56m liters of lubricants. This is in comparison to a collective production output of 45m liters, worth LKR11bn (USD96m), in 2009. This revenue CAGR of 23.6% during 2010-2012 indicates the opportunities prevalent in this industry, which is supported by the influx of new entrants over time.

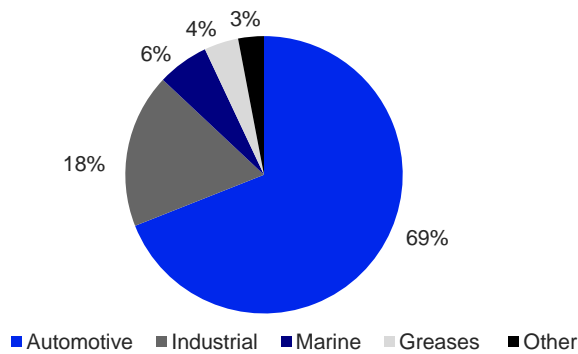
Figure 24: The lubricant industry has grown at a revenue CAGR of 23.6% over 2010-2012, with the volume CAGR at 7.8%



Source: Lubricant Market Reports, PUCSL

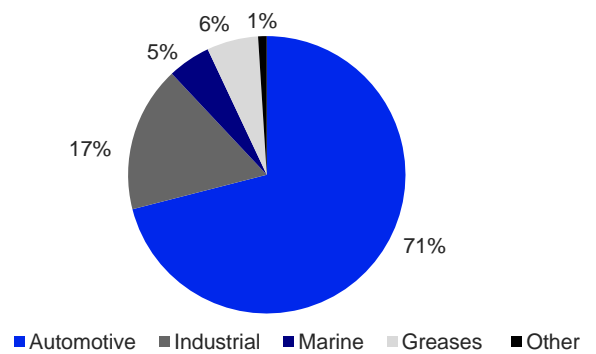
Of the total volume produced, the majority has been directed towards the automotive sector (approximately 70% of volume and value in 2012), with industrial, marine, greases and other industry sectors completing the mix. The main lubricant used in the automotive industry is engine oil, with other categories including gear oils, brake oils and power steering oils.

Figure 25: Lubricant sales volume by industry usage in 2012



Source: Lubricant Market Reports, PUCSL

Figure 26: Lubricant sales value by industry usage in 2012



Source: Lubricant Market Reports, PUCSL

Market participants

As of end-2012, LLUB continued to dominate the industry with a market share of 55%; however, this has declined drastically from 2008, when LLUB held 78%. LIOC followed in second place with 11%. The remaining 34% was split between the smaller players (Figure 27).

Figure 27: Parent company, authorized domestic operators and market share (by volume) in 2009 and 2012

Parent company	Authorized domestic operator	Market share 2012	Market share 2009
Chevron Ceylon Limited	Chevron Lubricants Lanka PLC	55.1%	72.9%
Indian Oil Corporation Limited	Lanka IOC PLC	11.1%	10.5%
Ceylon Petroleum Corporation	Ceylon Petroleum Corporation	9.9%	3.8%
ExxonMobil Asia Pacific Pvt Limited	McLarens Lubricants Limited	7.6%	4.0%
Laugfs Holdings Limited	Laugfs Lubricants Limited	3.4%	1.8%
Lubricant Company Sinopec Corporation	Interocean Lubricants Limited	2.8%	0.3%
Bharat Petroleum Corporation Limited	TVS Lanka (Pvt) Limited	2.8%	2.8%
BP France S.A.	Associated Motorways Limited	2.4%	0.0%
Shell Markets (Middle East) Limited	N.M. Distributors (Pvt) Limited	2.0%	2.8%
Ashland Inc.	United Motors Lanka Limited	1.3%	0.0%
Toyota Tsusho Corporation	Toyota Lanka Pvt Limited	1.3%	0.4%
Total Oil India Pvt Limited	Navaloka ABC Lubricants (Pvt) Limited	0.3%	0.1%
Motul	Dynamic Motors (Pvt) Limited	0.1%	0.1%
Gulf Oil International Limited	Western Auto Lanka (Pvt) Limited	-	0.4%

Source: Lubricant Market Report (2012), PUCSL

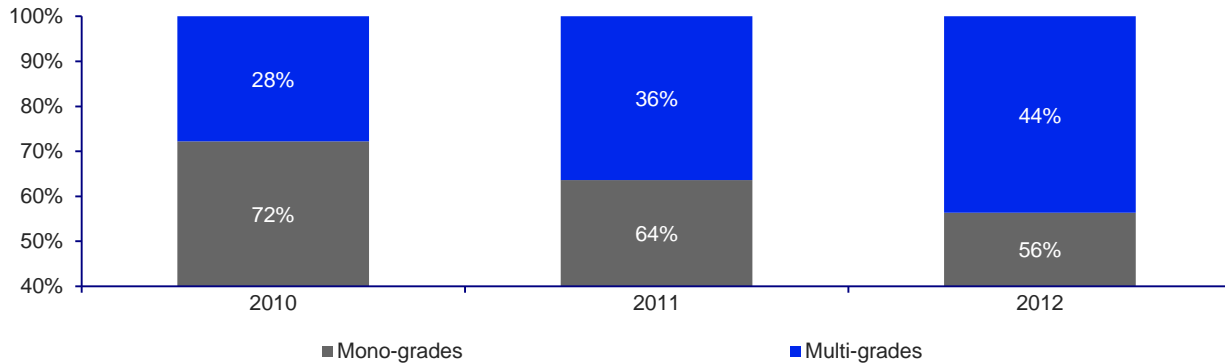
All 13 domestic participants (Gulf Oil International Limited did not renew its operating license in 2011) are authorized to import, export, sell, supply and distribute lubricants, while only two of these operators (Chevron Lubricants Lanka [LLUB] and Lanka IOC PLC [LIOC]) are in addition licensed to blend lubricants (using base oils and additives) for distribution. In 2012, around 65% (37m liters) of the total local lubricant requirement was produced by these two firms, with LLUB blending approximately 87% of that volume.

The blenders enjoy a raw material import tariff differential of around 20% over the finished lubricant importers (as reported by the PUCSL). We believe that this allows the blenders to enjoy relatively higher margins than other players, as their product offerings are priced more competitively.

Changing consumer dynamics

The domestic automotive retail consumer market is on the brink of a transition, where consumers are shifting towards higher-grade lubricants (multi-grade) from lower-tier (mono-grade) lubricants. In the past, mono-grade lubricants dominated the market, largely due to its cost effectiveness compared with multi-grade oils, which suits the requirement of the average cost-conscious Sri Lankan consumer. While mono-grades still retain the majority market share, this mix has shifted significantly over the past few years. In 2012, multi-grades accounted for 44% of the automotive retail volume mix, compared with just 28% in 2010.

Figure 28: The noticeable acceleration in the mix-shift from mono-grades to multi-grades should continue into the future

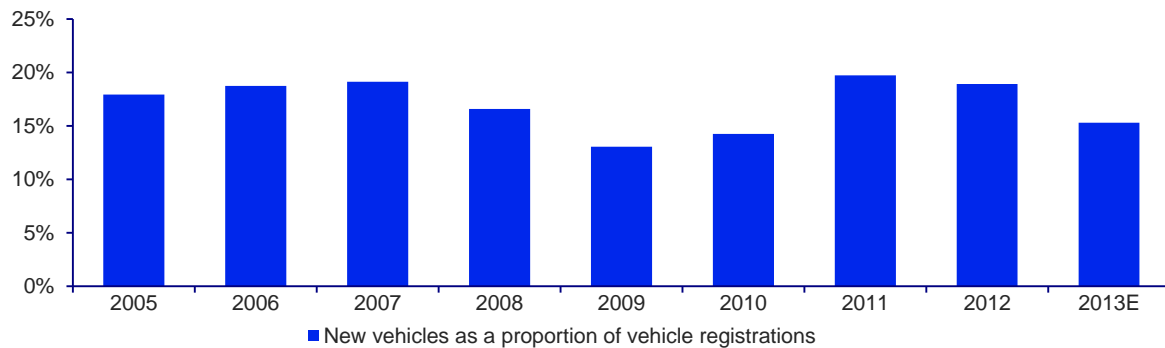


Source: Lubricant Market Reports, PUCSL

The main reasons for this emerging trend are discussed below:

- Influx of new vehicles into the market and changes in engine design.** Industry sources reveal that over 70% of the vehicles in use in Sri Lanka are older than ten years, hence there has never been a real need for high-quality engine oils. However, on average, new vehicle registrations (we define new vehicles as those less than two years old) make up around 15% of Sri Lanka's total vehicle population each year (Figure 29). We believe this is due to rising GDP per capita, which results in increasing customer affluence.

Figure 29: New vehicle registrations make up approximately 15% of the country's total vehicle population annually



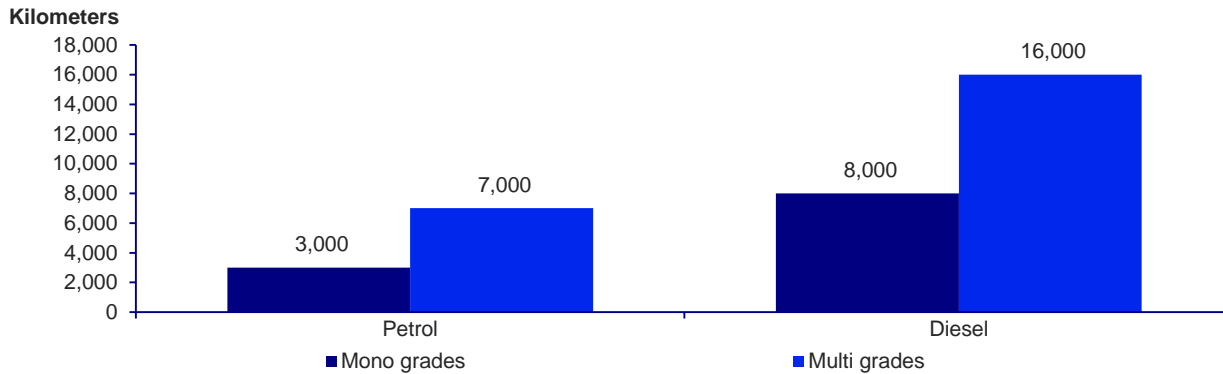
Source: Department of Motor Traffic, Sri Lanka, Copal Amba estimates

Note: The 2013 figure is based on Copal Amba estimates.

Most of these new vehicles come with new engine designs deploying advanced technologies (such as electronic fuel injection and higher injection pressures), which necessitate higher-grade engine oils to complement their functions. In addition, statistics from the Department of Motor Traffic (DMT) in Sri Lanka reveal that at present, on average, over 50 super luxury vehicles are registered monthly in the country; should this trend continue, it would support the growing demand for multi-grade oils.

- Greater customer awareness.** Domestic licensed operators have conducted several awareness campaigns around Sri Lanka, stressing on the importance of using higher-grade engine oils, and we believe this has and will continue to fuel demand for multi-grades.
- Extended drain intervals offered by multi-grades.** Oil drain intervals refer to the lag (in terms of kilometrage) between the frequency of a vehicle's engine oil change. Multi-grade lubricants are characterized by their longer drain intervals as shown in Figure 30.

Figure 30: Oil drain intervals (in km) of multi-grades are roughly twice that of mono-grades



Source: Sri Lanka Transport Board, Copal Amba estimates

The main advantages of longer drain intervals are for commercial vehicles (buses and lorries) by way of lower direct costs (servicing costs) and reduced opportunity costs (lost revenue during servicing). Hence, the most pronounced shift to higher-tier oils over the past few years have come from diesel lubricant users, with diesel multi-grades accounting for 20% of the market in 2012, compared with just 12% in 2010. The diesel vehicle segment accounts for the largest volume share in the lubricant market, with a 56% volume share in 2012, as reported by the PUCSL.

- **Growing original equipment manufacturer (OEM) influence.** There is an increasing trend for OEMs to recommend higher-tier lubricants (usually marketed by their own companies), in order to guarantee the performance of their vehicles. For example, Toyota recommends their own-branded multi-grade oils for their hybrid vehicles.
- **Emission regulation changes.** The DMT introduced vehicle emission tests for all petrol and diesel vehicles, effective January 2011. This is mandated for all vehicles in order to obtain a revenue license. The use of incorrect oils and concentration of lubricants lead to higher vehicle emissions, according to our discussion with industry experts. Therefore, these regulations could lead to greater use of better-quality lubricants.

Industry regulation

The industry is regulated by the Ministry of Petroleum (MoP), with the Public Utilities Commission of Sri Lanka (PUCSL) nominated as the shadow regulator. In this respect, the PUCSL advises the MoP on policies and other regulatory matters. The Sri Lanka Standards Institute (SLSI) has published standards for all types of lubricants stipulated by the GoSL, based on international standards published by organizations such as the American Petroleum Institute and the Japanese Automobile Standards Organization. The GoSL's main source of income from the licensed lubricant operators is by way of a semi-annual registration fee, equivalent to LKR1m or 0.5% of total invoiced sales for the period, whichever is higher (subject to a maximum of LKR5m).

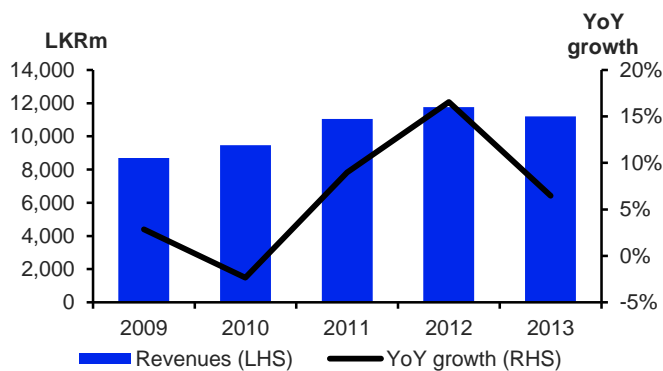
Appendix 2: Company overview

Established in 1992 under the global parent Chevron Corporation, Chevron Lubricants Lanka PLC (LLUB) was listed on the CSE in 1996. With a market capitalization of LKR33.4m (USD255m) as at 24 February 2014 and a market share of 55% in 2012 (according to the Public Utilities Commission of Sri Lanka – PUCSL), LLUB is the market leader in the local lubricant industry.

LLUB is engaged in blending, manufacturing, importing and distributing petroleum-based lubricants and offers lubricant solutions for consumer, industrial and commercial applications. It is one out of only two licensed blenders in the country. Its three main brands, Caltex, Havoline and Delo, help LLUB to retain its strong position in the local market, while approximately 6% of its group revenue is obtained from exports to the Maldives and Bangladesh.

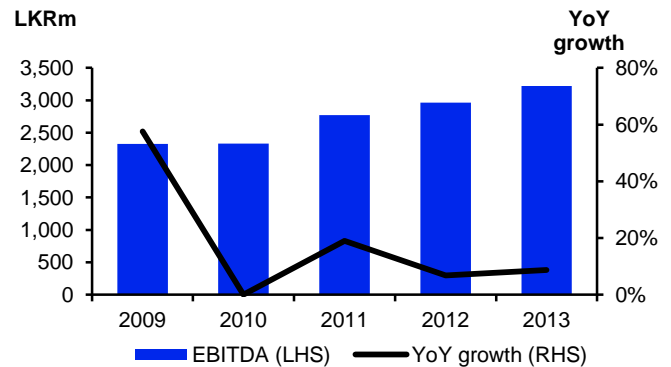
LLUB recorded LKR11.2bn in revenue for 2013, with a CAGR of 6.6% over 2010-2013; the automotive segment generated roughly two-thirds of group revenue. The group generated EBITDA of LKR3.2bn in 2013, representing an 8.5% CAGR over 2010-2013.

Figure 31: LLUB's revenue grew at a 6.6% CAGR over 2010-2013



Source: LLUB

Figure 32: LLUB's EBITDA grew at an 8.5% CAGR over 2010-2013



Source: LLUB

LLUB's business segments

The Sri Lankan lubricant industry can be divided up based on the products' end usage into automotive, industrial, marine, greases and other sectors. LLUB also caters to these end-user segments.

Automotive

Under this segment, LLUB provides a wide variety of engine oils, including passenger vehicle engine oils, four stroke motor cycle engine oils, two stroke and outboard engine oil, general purpose automotive gear oils, diesel vehicle engine oils, and automatic transmission oils. These products cater to a large range of automobiles in the country, including passenger cars, SUVs, light-duty commercial vehicles, motorcycles, on-road trucks and buses. Havoline is the premium brand for the petrol car engine segment, while Delo is the main brand for diesel vehicle engines. The Lanka brand caters to cost-conscious consumers.

Industrial

LLUB's industrial products include industrial lubricants, hydraulic oils, industrial gear lubricants, metal working fluids, way lubricants, thermic oils, and air tools and rock drills. The various products

under these categories are marketed through the Caltex brand. These industrial oils cater to steam and gas turbines, and various other machinery aiding in increasing their efficiency and reducing every day wear and tear as they operate under harsh conditions.

Marine

The marine products range consists of trunk piston engine oil and cylinder oil for cross head type marine engines under the Delo and Tara brands, offering high and low alkaline reserve engine oils for marine engines. LLUB's marine products also fall under the Caltex brand, and cater to a wider range of marine and stationary applications with low- to medium-speed engines.

Greases

LLUB's greases product offerings cater to both automotive and industrial sectors for use in a wide range of applications, and includes brands such as Marfak, Multifak, Molytex, Starplex and Thermatex – all of which fall under the Caltex umbrella.

Specialty and other products

LLUB markets a range of specialty fluids for specific automotive and industrial applications. These include premium performance, environmentally sensitive coolants with anti-freeze and corrosion-inhibiting properties, premium non-petroleum automotive brake fluids, as well as premium multi-functional tractor hydraulic fluids.

Management strategy, transparency and governance

One of the highlights in 2014 would be the new blending plant LLUB is constructing at Sapugaskanda (a suburban town 18km from Colombo). The company is currently operating in Kolonnawa (7km from Colombo) and is expected to commence operations at the new plant by June 2014.

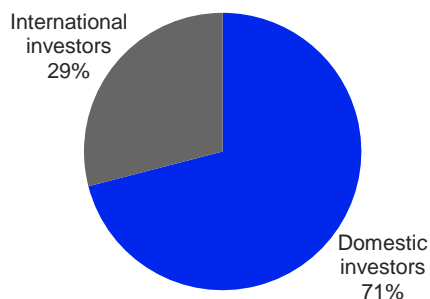
While LLUB's disclosure levels may be sound by local standards, it still lags those of international peers. This poses a number of challenges to the analytical process, including the following:

The company's disclosure at a segment level is insufficient to arrive at accurate calculations and forecasts. Key items such as breakdown of revenue and volumes at product or segment level and details of direct expenses are unavailable. The management discussion and analysis section of the annual report does not list LLUB's specific targets (ROE, margins expected, market share, etc.), and investors and analysts have to make assumptions regarding the company's future direction. In addition, quarterly operational disclosure levels are also minimal at best. We believe providing these additional details on a quarterly and annual basis would be of greater value to current and potential investors.

Shareholding structure

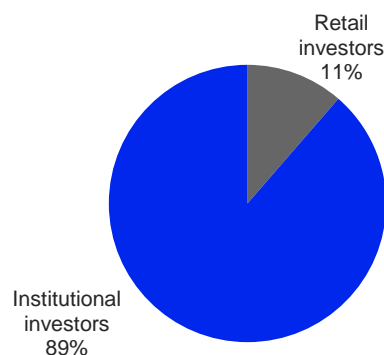
Domestic investors hold 71%, and institutional investors (both domestic and international) hold 89% of LLUB's shares. Chevron Ceylon Limited is the largest shareholder, with a 51% stake.

Figure 33: LLUB is 71% domestic owned; Chevron Ceylon Limited is the largest shareholder with 51%



Source: LLUB, as of December 2012

Figure 34: Institutional investors hold close to 90% in LLUB



Source: LLUB, as of December 2012

The top five shareholders as of 31 December 2013 are presented below.

Name of shareholder	Description	Stake
Chevron Ceylon Limited	Parent company	51.0%
HSBC Int'l Nominees Ltd – BPSS Lux Aberdeen Global	A global fund	7.9%
HSBC Int'l Nominees Ltd – BPSS Lux Aberdeen Global – EME	A fund focusing on smaller companies in emerging markets	4.3%
HSBC Intl Nom Ltd – SSBT Wasatch Frontier Emerging Small	A fund focusing on small companies in frontier markets	3.9%
Caceis Bank Luxembourg – Barca Global Master Fund Lpogier	A leading asset servicing provider in Europe	2.3%

Source: LLUB

Board of directors

As of December 2013, LLUB's board comprised six directors. Their details are provided below.

Name of Director	Description
Mr. Farrukh Saeed	Chairman of LLUB and currently functions as vice president of lubricants (Asia Pacific). He has over 29 years of experience with Chevron.
Dr. Kishu Gomes	Managing director and CEO of LLUB, and managing director of Chevron Ceylon Ltd. He joined Caltex in 1997, and became the first Sri Lankan Managing Director/CEO of Caltex Lubricants Lanka Ltd in 2000.
Mr. Anura Perera	Director of finance, and was appointed to the board in 2002. He is also a director of Chevron Ceylon Ltd. He joined LLUB in 1996 and has over 23 years of experience in accounting and finance.
Mr. Devasiri Rodrigo	Non-executive independent director since 2009. He also serves as a director of Cargills Bank Limited, Softlogic Holdings PLC and Ceylon Tobacco Company PLC.
Mr. Richard Brown	Non-executive director with over 30 years of experience with Chevron. He currently serves as the regional finance officer for the Asia-Pacific region.
Mr. Harsha Amarasekera	Joined the board as a director, effective June 2013. Mr. Amarasekera is a lawyer by profession, specializing in commercial, business, securities, banking and intellectual property law.

Source: LLUB

Appendix 3: SWOT analysis

Strengths

- Higher margins compared with other importers due to a tariff advantage stemming from local blending
- Market leadership position provides scale benefits
- Global brand strength of specialization
- Less sensitivity towards temporary price fluctuations in base oil prices due to LLUB sourcing from the parent and the importation of bulk base-oils, as opposed to finished products
- Zero-debt balance sheet provides alternative financing options

Weaknesses

- Eroding market share due to the lack of a competitive advantage and unique selling proposition
- Losing grip on the distribution network to other captive channel owners

Opportunities

- The shift to higher-tier oils should improve profitability
- Growth in new vehicle registrations to accelerate demand for lubricant products
- Opportunity to use cash reserves for further expansion (vertical and horizontal integration, for example)

Threats

- Further liberalization of the lubricant market by the government could pave the way for new competitors
- Adverse changes to tariffs and permits on vehicle imports by the government could hinder growth in the number of new vehicle registrations, thereby restraining the lubricant market's growth potential
- Significant fluctuations in base-oil prices and LKR depreciation could pressure LLUB's margins
- Lower demand from thermal power plants (during times when hydro power plants generate electricity)
- Adverse weather conditions impacting the agriculture and fisheries sectors
- Extended oil-drain intervals reducing lubricant volumes consumed

Appendix 4: Key financial data

Summary group financials (LKRm)

INCOME STATEMENT	2011	2012	2013	2014E	2015E	2016E
<i>(For the year ended 31st December)</i>						
Revenue	11,040	11,754	11,202	11,785	12,413	13,079
Gross profit	3,474	3,804	4,125	4,462	4,835	5,219
EBITDA	2,773	2,961	3,221	3,421	3,634	3,856
EBIT	2,725	2,917	3,175	3,314	3,522	3,748
EBT	2,768	3,111	3,454	3,699	3,922	4,187
Net profit	2,001	2,266	2,532	2,775	2,941	3,140

BALANCE SHEET	2011	2012	2013	2014E	2015E	2016E
<i>(As at 31st December)</i>						
Current assets						
Cash and cash equivalents	1,012	2,517	2,485	1,852	1,872	2,156
Accounts receivable	1,187	987	1,252	1,453	1,871	2,043
Inventories	1,870	2,132	1,929	1,906	1,869	1,831
<i>Total current assets</i>	<i>4,070</i>	<i>5,636</i>	<i>5,666</i>	<i>5,210</i>	<i>5,611</i>	<i>6,030</i>
Non-current assets						
Property, plant and equipment	193	216	1,297	2,451	2,401	2,358
<i>Total non-current assets</i>	<i>284</i>	<i>311</i>	<i>1,387</i>	<i>2,541</i>	<i>2,490</i>	<i>2,448</i>
Total assets	4,354	5,948	7,052	7,751	8,102	8,477
Current liabilities						
Accounts payable	721	1,257	1,600	1,605	1,661	1,723
<i>Total current liabilities</i>	<i>1,094</i>	<i>1,734</i>	<i>2,090</i>	<i>2,096</i>	<i>2,152</i>	<i>2,213</i>
Non-current liabilities						
<i>Total non-current liabilities</i>	<i>102</i>	<i>87</i>	<i>122</i>	<i>122</i>	<i>122</i>	<i>122</i>
Equity						
Common share capital	600	600	600	600	600	600
Retained profit	2,558	3,526	4,240	4,934	5,228	5,542
<i>Total equity</i>	<i>3,158</i>	<i>4,126</i>	<i>4,840</i>	<i>5,534</i>	<i>5,828</i>	<i>6,142</i>
Total liabilities and equity	4,354	5,948	7,052	7,751	8,102	8,477

CASH FLOW STATEMENT	2011	2012	2013	2014E	2015E	2016E
<i>(For the year ended 31st December)</i>						
Operating activities						
<i>Net cash flow from operating activities</i>	<i>1,350</i>	<i>2,789</i>	<i>2,480</i>	<i>2,559</i>	<i>2,578</i>	<i>2,999</i>
Investing activities						
Purchase of PPE and intangible assets	(21)	(68)	(1,128)	(1,261)	(62)	(65)
<i>Net cash flow from investing activities</i>	<i>28</i>	<i>97</i>	<i>(892)</i>	<i>(1,111)</i>	<i>90</i>	<i>112</i>
Financing activities						
Dividends paid to common shareholders	(1,020)	(1,380)	(1,620)	(2,081)	(2,647)	(2,826)
<i>Net cash flow from financing activities</i>	<i>(1,021)</i>	<i>(1,380)</i>	<i>(1,620)</i>	<i>(2,081)</i>	<i>(2,647)</i>	<i>(2,826)</i>
Net increase/(decrease) in cash and cash equivalents	356	1,505	(32)	(633)	20	285

Key ratios

KEY RATIOS	2011	2012	2013	2014E	2015E	2016E
Growth						
Revenue growth (%)	16.6	6.5	(4.7)	5.2	5.3	5.4
EBITDA growth (%)	19.0	6.8	8.8	6.2	6.2	6.1
EBIT growth (%)	20.2	7.1	8.8	4.4	6.3	6.4
Net profit growth (%)	33.3	13.3	11.7	9.6	6.0	6.8
Recurrent diluted EPS growth (%)	33.3	13.3	11.7	9.6	6.0	6.8
Margins						
EBITDA margin (%)	25.1	25.2	28.8	29.0	29.3	29.5
EBIT margin (%)	24.7	24.8	28.3	28.1	28.4	28.7
Net profit margin (%)	18.1	19.3	22.6	23.5	23.7	24.0
ROCE (%)	70.3	56.9	50.7	46.8	45.5	46.0
ROE (%)	74.2	62.2	56.5	53.5	51.8	52.5
Liquidity and Efficiency						
Current ratio (x)	3.7	3.2	2.7	2.5	3.7	3.2
Total asset turnover (x)	2.5	2.0	1.6	1.5	2.1	1.9
Gearing and Cash Flow						
Debt/Capital (%)	-	-	-	-	-	-
Free cash flow (FCF) yield (%)	5.4	8.5	4.2	3.9	7.5	8.8
Net debt/FCF (x)	0.8	0.9	1.8	1.4	0.7	0.7
Valuation						
P/E (x)	12.2	14.2	12.7	12.0	11.3	10.6
P/BV (x)	7.7	7.8	6.6	6.0	5.7	5.4
EV/EBITDA (x)	8.4	10.0	9.2	9.0	8.5	8.0
EV/Sales (x)	2.1	2.5	2.6	2.6	2.5	2.4
EV/FCF (x)	17.6	10.9	21.9	23.7	12.2	10.5

PER SHARE DATA	2011	2012	2013	2014E	2015E	2016E
Recurrent diluted EPS	16.67	18.88	21.10	23.12	24.51	26.17
Common dividend	9.00	11.00	15.00	17.34	22.06	23.55
Book value	26.32	34.38	40.33	46.11	48.57	51.18
Net operating cash flow	11.25	23.24	20.67	21.33	21.48	24.99
Net cash flow	2.97	12.54	(0.27)	(5.27)	0.17	2.37

Source: LLUB, Copal Amba estimates

FX rates (USD/LKR): Y/E 31 December 2013 = 129.15

Y/E 31 December 2012 = 127.66

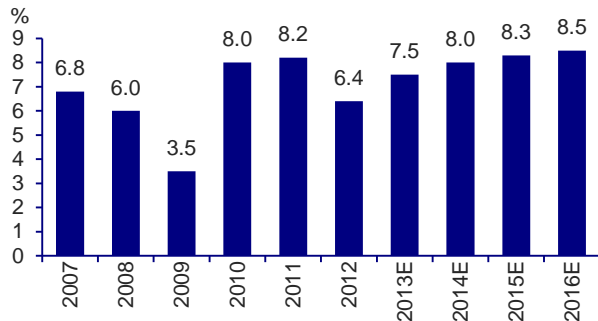
Y/E 31 December 2011 = 110.54

Fact sheet

Sri Lanka investment environment overview

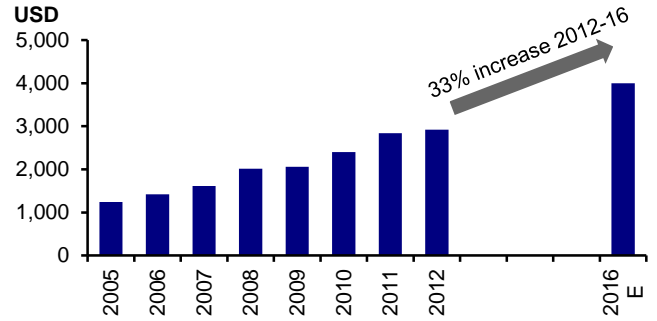
Sri Lanka's economy has been on an upward trajectory since the end of the three-decade civil war in May 2009. Sri Lanka currently boasts South Asia's highest GDP growth, conducive fiscal and monetary policy, and favorable socio-economic conditions, which together create an attractive investment destination.

Figure 35: Sri Lanka's GDP projected to increase at a 7% CAGR 2012-2016E



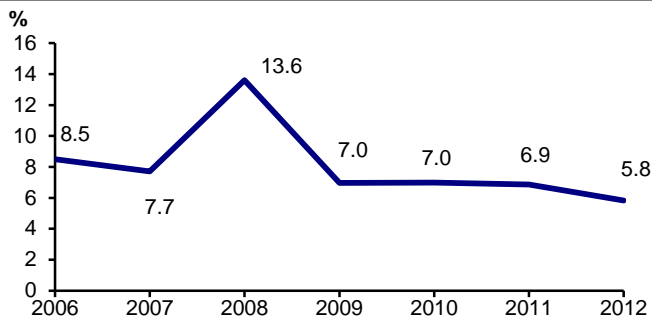
Source: Central Bank of Sri Lanka, Department of Census and Statistics

Figure 36: GDP per capita to increase 33% by 2016E



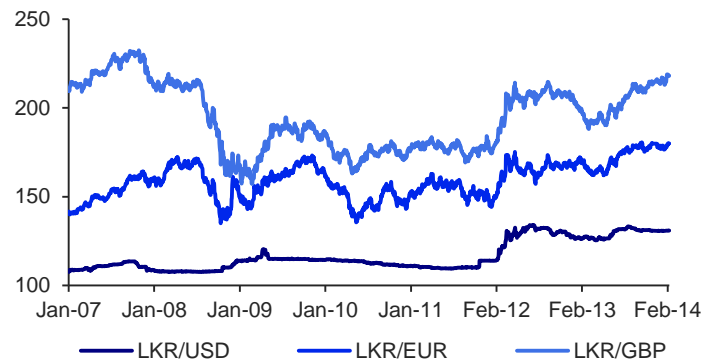
Source: Central Bank of Economic and Social Statistics of Sri Lanka 2012, Road Map 2013 - Central Bank of Sri Lanka

Figure 37: Annual core inflation post-war has averaged 6.7%, government targeting mid-single digit levels in the medium term



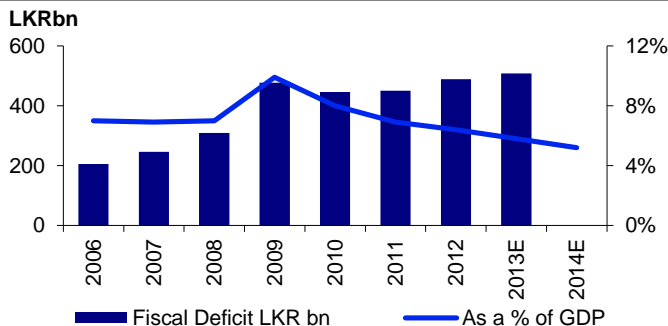
Source: Department of Census and Statistics, Central Bank of Sri Lanka

Figure 38: CBSL expects the rupee to stabilize in the medium term despite recent volatility



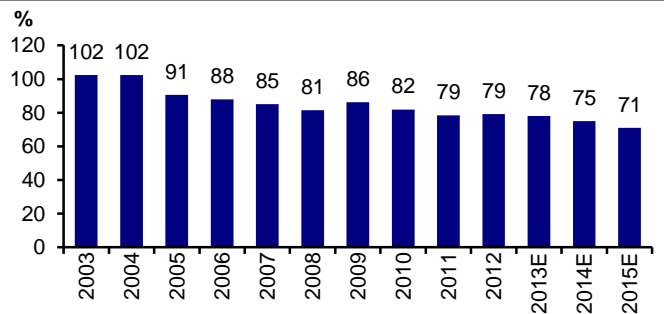
Source: Bloomberg

Figure 39: Fiscal deficit target of 5.2% of GDP for 2014E



Source: Central Bank of Sri Lanka

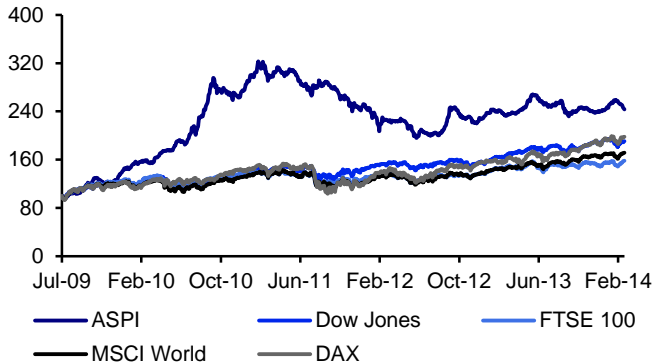
Figure 40: Debt-to-GDP to fall to 71% by 2015E



Source: Central Bank of Sri Lanka

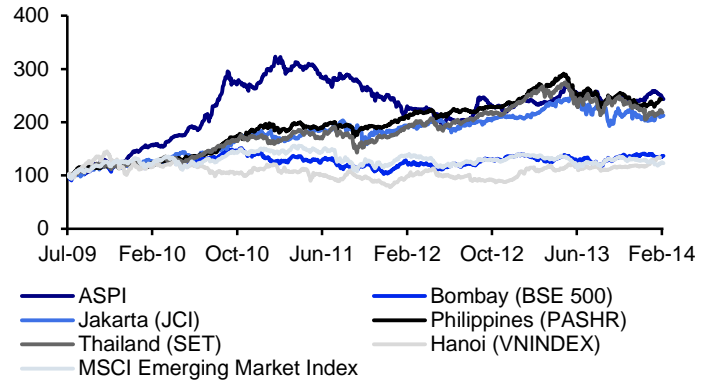
The Sri Lankan equity market offers a rare and attractive alternative to investors in an investment era impacted by economic growth worries. Backed by the country's robust economic growth, the Sri Lankan capital market is well set to offer attractive returns to investors who are keen to be a part of this emerging market success story. There are several strong incentives for entering the Sri Lankan capital market.

Figure 41: Post war, the ASPI has significantly outperformed global and developed market indices



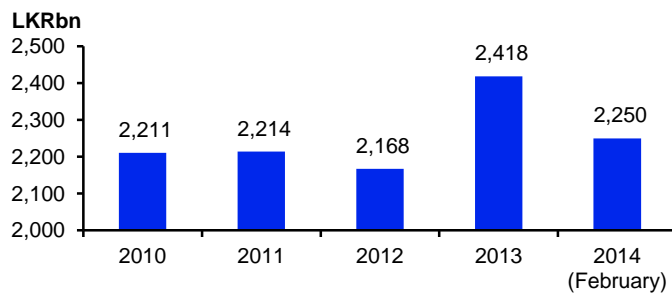
Source: Bloomberg
*Note: All figures re-based to 1 July 2009

Figure 42: Post war, the ASPI has also outperformed some of the best-performing regional indices



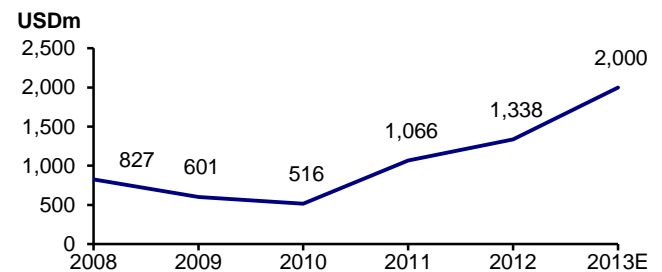
Source: Bloomberg
*Note: All figures re-based to 1 July 2009

Figure 43: The CSE's market capitalization has doubled since 2009



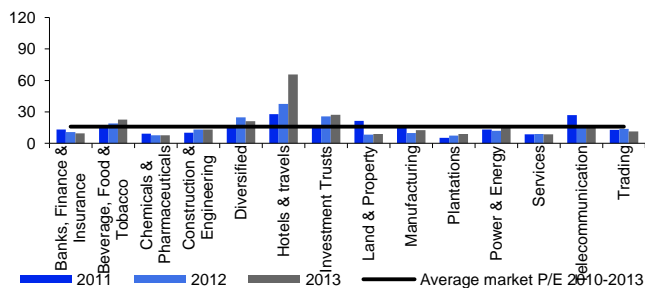
Source: Bloomberg, Central Bank of Sri Lanka

Figure 44: The government anticipates FDI inflows to reach USD2bn in 2013, a 19% CAGR 2009-2013E



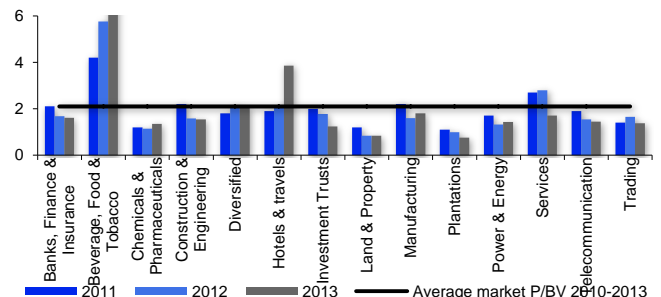
Source: Ministry of Finance and Planning, Board of Investment of Sri Lanka

Figure 45: Most sector P/E's are below market average and historical valuations



Source: Colombo Stock Exchange

Figure 46: Trend is similar on a P/BV value



Source: Colombo Stock Exchange

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