October 31, 2022

Valvoline Cummins Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term/Short term - Fund based/Non-fund based limits^	50.0	50.00	[ICRA]AA+ (Stable)/[ICRA]A1+; reaffirmed
Short term non-fund based limits	5.0	0.00	-
Long term - Fund based limits	100.0	100.00	[ICRA]AA+ (Stable); reaffirmed
Total	**155.00**	**150.00**	

**Instrument details are provided in Annexure-I ^Interchangeable Limits*

Rationale

The reaffirmation of the ratings of Valvoline Cummins Private Limited (VCPL) factors in its position as one of the leading players in the lubricant industry, supported by its strong brand presence, technical support from promoter company Valvoline Inc[1], a well-entrenched distribution network and a wide product portfolio. These factors coupled with the captive business of/association with other promoter company Cummins India Limited[2] (CIL) and the various marketing initiatives undertaken by VCPL have resulted in a steady volume growth for VCPL. The ratings also factor in VCPL's comfortable financial profile, characterised by a strong capital structure, its debt-free status, and the healthy debt protection metrics, return indicators and liquidity position. The marketing initiatives undertaken by the company, along with the stable demand prospects for lubricants in India in the near to medium term, are likely to keep the volume growth steady for VCPL, going forward.

The ratings, however, are tempered by the highly competitive nature of the industry and the susceptibility of VCPL's profit margins to the volatility in key raw material (base oil) prices and foreign exchange rates, as a sizeable part of the raw material requirement is being met through imports. There has been a substantial increase in the base oil prices in the last couple of years which has impacted VCPL's margins. This, coupled with the increase in revenue proportion from OEM and industrial segment which carry relatively low margin, have also exerted pressure on profitability in FY2022. Additionally, a sizeable proportion of the revenue is generated from the auto sector, exposing it to sectoral concentration risk. The increased penetration of electric vehicles (EV) can result in some moderation in demand for lubricants in the long term. However, the EV industry in India is still at a nascent stage and its impact on lubricant sales is not expected to be material in the medium term. Notwithstanding the same, the company remains focussed on enhancing the revenue contribution from other sectors to diversify its revenue mix. ICRA has also taken note of the continued sizeable dividend pay-out by the company which moderates the net cash accruals, though partly offset by no major capex and other growth plans and its debt-free status.

In August 2022, The Saudi Arabian Oil Company (Aramco) agreed to acquire Valvoline Inc's global products business for a consideration of US$2.65 billion, along with the Valvoline brand name. While this is not expected to have any major impact on Indian operations, the same will remain a monitorable.

The Stable outlook reflects ICRA's expectation that VCPL will continue to benefit from a steady demand outlook, its established brand presence and well-entrenched distribution; enabling the company to generate healthy internal accruals and sustain its liquidity position.

[1] rated Ba2 (Rating under Review) by Moody's Investors Service. The Global products segment is now being acquired by Saudi Arabian Oil Company (Aramco)

[2] Step-down subsidiary of Cummins, Inc. which is rated A2(Stable)/P-1 by Moody's Investors Service

Key rating drivers and their description

Credit strengths

Established business position, supported by strong brand presence and technical support of promoter Valvoline Inc. – VCPL is one of the leading players in the lubricant industry, supported by its strong brand presence, technical support from promoter company Valvoline Inc, well-entrenched distribution network and wide product portfolio. The Valvoline Cummins brand is among the well-known brands in the Indian lubricant market and VCPL pays a royalty to Valvoline Inc. for the use of the Valvoline brand names and service charge to CIL for its marketing and selling network. Owing to its association with Valvoline Inc., the company has access to a large database of formulations and enjoys R&D support, which places it favourably to cater to a variety of applications in the lubricant sector in India. Going forward, the impact of the acquisition of the global products business of Valvoline Inc. by Aramco on the Indian business will be monitored.

Strong marketing and distribution network to cater to retail sales in the domestic market – In terms of segment-wise sales, the retail segment has continued to account for the highest share, both in volume and value terms. However, the adverse impact of the pandemic and lower demand in the two-wheeler segment moderated the contribution of retail sales in FY2022. The company has developed a well-entrenched distribution network over the years, with around 450 distributors and 55,000-60,000 retailers across the country. VCPL is one of the youngest multinational player in the Indian market, yet it continues to grow at a rate higher than the industry average, also supported by various marketing initiatives.

Large captive business of promoting company "CIL" - VCPL benefits from the sizeable captive business of its promoting company, CIL, which commands a strong market position in the diesel engine market (for power, auto and industrial usage). Moreover, the tie-up of Cummins with other OEMs like Tata Motors has garnered incremental business for VCPL.

Comfortable financial risk profile - VCPL registered an operating income of Rs. 1,695.9 crore in FY2022 against Rs. 1,341.9 crore in FY2021, supported by growth in volumes and higher realisation. The higher realisation was on account of elevated prices of input raw material i.e. base oil and other components. Moreover, the company's capital structure remains comfortable with sizeable net worth and net debt-free status and strong debt protection metrics. However, the margins were impacted in FY2022 (operating margins at ~11-12% vis-à-vis 16-17% in FY2021) due to the spike in raw material prices and growth in end-user segments-Industrial, OEMs with slightly thin margins. Going forward, the profitability is likely to improve with the moderation in base oil prices, in addition to the price revisions undertaken by the company. However, continued sizeable dividend payouts by the company moderate the net cash accruals, though partly offset by no major capex and other growth plans. The financial profile of the company is likely to remain comfortable, going forward, supported by healthy internal accrual generation and no debt-funded capex.

Credit Challenges

Highly competitive industry – The lubricant oil industry is characterised by the presence of a few large players, including oil marketing companies (OMC), other relatively large players and a number of unorganised players, which limits the pricing flexibility of the industry participants. However, VCPL continues to benefit to some extent because of its strong brand presence and technical support from Valvoline Inc., enabling it to earn healthy margins.

Industry growth moderated by technological developments; increased penetration of EVs can result in moderation of sales - The lubricant industry's growth has been impacted by technological developments, leading to reduced frequency of lubricant change and reduction in sump sizes. However, VCPL's marketing and R&D initiatives have enabled it to outpace industry growth. Moreover, increased penetration of EVs can result in some moderation in demand for lubricants. However, the EV industry in India is still at a nascent stage and its impact on lubricant sales is not expected to be material in the medium term.

Vulnerability of profitability to fluctuations in raw material prices and foreign exchange risks - VCL's major raw material is base oil (a derivative of crude oil) and 55-60% of the requirement is met through imports from some recognised vendors. This exposes the profitability to the fluctuations in crude oil prices and forex rates. The product prices for some consumer segments, however, cannot be revised immediately to absorb the price volatility due to market forces. This was also evident in recent quarters wherein the base oil prices firmed up considerably due to pandemic-related disruption and the ongoing Russia-Ukraine war, leading to moderation in VCPL's margins. However, base oil prices are expected to settle down, going forward, rendering stability to the company's margins.

Vulnerability of sales to any slowdown in auto sector - A sizeable part of the revenue is generated from the auto sector, making the company vulnerable to any slowdown in this sector. While the long-term outlook for the automotive sector remains strong, VCPL's growth will continue to be linked to any intermittent demand fluctuations from the automotive segment.

Liquidity position: Adequate

VCPL's liquidity is adequate, supported by healthy internal accrual generation, free cash balances/liquid investments (~Rs. 61 crore as of July 2022 end) and undrawn bank lines as Fund Based Limits utilisation remains minimal. While the dividend payout is expected to remain high, in line with the past trend, it is not expected to weigh down on the company's liquidity as it does not have any long-term debt repayment liability or any major capex plans over the medium term.

Rating sensitivities

Positive factor – The ratings could be upgraded if there is a significant growth in VCPL's scale along with increased product diversification to the non-automotive segment and expansion in market share. The ratings may also be revised upwards if the company is able to maintain healthy profitability amid a comfortable capital structure and liquidity on a sustained basis.

Negative factor – A sizeable decline in VCPL's revenue and profitability and stretching of the working capital cycle may exert pressure on the liquidity position and trigger a downgrade. Any sizeable debt-funded capex could also lead to a downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

VCPL was incorporated in 1994 and promoted by Valvoline International Inc. in a joint venture with Cummins India Limited in which the partners hold 50% equity each. Valvoline Cummins Private Limited (VCPL) is engaged in the distribution and marketing of automotive lubricants, transmission fluids, gear oils, hydraulic lubricants, automotive chemicals, specialty products, greases, and cooling system products. Since its inception, the company had outsourced manufacturing to a toll blender in Mumbai. However, with the setting-up of its own manufacturing facility at Ambernath in Maharashtra in 2013, the company has shifted its entire production to the latter. The company was converted from a limited company to a private limited company with effect from October 14, 2015.

Key financial indicators (audited)

VCPL Standalone	FY2021	FY2022
Operating income	1,341.9	1695.9
PAT	159.6	135.6
OPBDIT/OI	16.9%	11.4%
PAT/OI	11.9%	8.0%
Total outside liabilities/Tangible net worth (times)	1.5	1.1
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	81.2	75.3

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)	Date & rating in	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					October 31, 2022	Aug 27, 2021	Apr 27, 2020	Apr 12, 2019
1	**Fund based/Non-fund based limits^**	Long Term/Short Term	50.0	NA	[ICRA]AA+ (Stable)/[ICRA]A1+	[ICRA]AA+ (Stable)/[ICRA]A1+	[ICRA]AA+ (Stable)/[ICRA]A1+	[ICRA]AA+ (Stable)/[ICRA]A1+
2	**Fund based limits**	Long-Term	100.0	NA	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	-	-
3	**Non-fund based limits**	Short-Term	0.0	NA	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

^interchangeable limits

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term/Short Term - Fund Based/Non-Fund Based Limits	Simple/Very Simple
Long Term - Fund Based Limits	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Long Term/Short Term - Fund Based/Non-Fund Based Limits**	NA	NA	NA	50.0	[ICRA]AA+(Stable)/[ICRA]A1+
NA	**Long Term - Fund Based Limits**	NA	NA	NA	100.0	[ICRA]AA+(Stable)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis: Not Applicable

ANALYST CONTACTS

Sabyasachi Majumdar
+91 145 4545 304
sabyasachi@icraindia.com

Prashant Vasisht
+91 124 4545 322
prashant.vasisht@icraindia.com

Ankit Jain
+91 124 4545 865
ankit.jain@icraindia.com

Neha Mangal
+91 124 4545 367
neha.mangal@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches