Interview

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V. K. Mathew

CEO

Flight towards diversity

June 30, 2016

V. K. Mathew, CEO of Avi-Oil, sits down with TOGY to discuss his company's current field of operations, challenges facing diversification in the lubricants sector and advice to investors looking to enter the Indian market. The firm mainly supplies India's defence sector with specific lubricants for aviation and other vehicles.

What kind of services do you provide the Indian oil industry?

Avi-Oil was founded in 1993 as a joint venture between Indian Oil, NYCO and Balmer Lawrie, specifically to ensure self-reliance in the strategic area of military lubricants for the Indian defence forces.

The Indian defence forces were facing difficulties getting imported lubricants for their fleet because of embargos on specific imports from US and Russia. If you can't get the lubricants, the aircraft can't fly, which caused aircrafts to be occasionally grounded. During a time of war, you cannot afford that kind of situation, so the government took a decision that they needed to manufacture these products in India.

They also decided that they needed to have 50% ownership since none of the Indian players had the technology at the time to make these highly sophisticated products. But now we are quite proud to say that we supply 80-85% of the aviation lubrication needs of India's air force, army and navy, the entire defence force

Although our main technical knowhow comes from NYCO, we were formed to take care of defence and if one of our defence divisions has a particular requirement, which may not be a huge requirement worldwide, we are obligated to develop that product. We have a small research and development centre set up within our factory at Faridabad which develops these products. We also export, mainly to Sri Lanka, Nepal and Bhutan.

What are the difficulties in manufacturing such niche products?

In aircraft product manufacturing, you need aircraft-manufacturer and engine-manufacturer approvals. These approval processes take time and cost a lot. Additionally, there is a separate body in India called the Center for Military Airworthiness and Certification which approves products for specific aircrafts. The methodology used by the defence industry for the procurement of products is that each and every batch that is made will be inspected by recognized agencies, which in this case is the Directorate General of Aeronautical Quality Assurance. They come over to the plant to evaluate and monitor each and every batch that we make, and we can only supply our products until after they have evaluated them.

While this is a tedious and time-consuming process, it keeps the competition at bay. Nobody is going to spend time getting into this business and going through these stringent procedures. We are in this business for a long time and it is going to be difficult to displace us.

The whole strategy of our company leans towards small volumes, about 2,500 tonnes of products, but with highly intensified approval processes. Large oil companies cannot do this as they are focused on volume. They cannot have five or six days a month dedicated to inspections.

However, we do have room for expansion. To do that, we need to change our business model with our clientele. The Indian Air Force does business on long term fixed-price contracts, which are not very conducive to growing our business and financials. At the moment, if costs go up, we cannot change our prices.

For me, the priority is to double our volume, double the turnover and, most importantly, increase our margin by 2020. Today the margin is the biggest challenge because of these fixed prices.

AVI-OIL

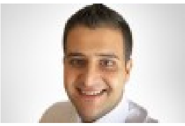
IN FIGURES

Percent the firm holds of the defence force's lubricant market:

80-85%

Forecasted number of aircrafts in India's air force by 2020:

800



In 2015, Airbus said that India will be one of the world's top aviation markets in 20 years. What are AVI-OIL's opportunities for expansion?

Civil aviation is one clear area for expansion. We have not traditionally focussed on that area. We have always been behind defence. Now that we have a reasonably good market share, it is time we start going into new areas, including civil aviation. We could work with private airlines like Indigo or Jet Airways.

My understanding is that by 2020, the total fleet of large aircrafts will rise to 800 from the current 430 or so. Even smaller business jets, smaller aircrafts and helicopters and so on are going to increase by 800 to 850 in the next five years. This is a huge opportunity for us to penetrate an area where we have not traditionally been focussed.

The advantage for us is that we already have the infrastructure in place. The product is already being manufactured. Our only area of work is to really focus on the market and work out our route-to-market. We need to decide whether we go directly to the companies or whether we need to use distributors for these smaller aircrafts. We are working this out right now.

How do you see the company evolving in the coming years, specifically towards the oil and gas industry?

For the next few years, we are going to consolidate our defence business, grow in civil aviation and esters – the raw material – for industrial purposes. We have a couple of finished industrial lubricants, one of which is synthetic dielectric fluids for transformers.

Since we also make the esters for aviation products, we have now started selling these to other oil companies who can then create other finished products for various automotive and industrial applications.

The synthetic market in India is very small right now, less than 1%, but it is going to grow. There are three major categories of synthetics: polyalphaolefin, polyalkylene glycol, and esters. At the moment we only market esters, so this is an area of growth for the future in the industry and we intend to take part in it.

We intend to sell the esters to all interested oil companies. There are already industrial applications where synthetic bases can be used, for example with air compressor oils, synthetic refrigeration compressor oils, dielectric fluids and chain oils.

There are a few regions where synthetic lubricants have started picking up. We have seen that globally, and we know that it will come to India. The second major area where we see growth is in the automobile industry where fuel efficiency is going to be the trend in the future. They will need to use esters.

What would you say to international investors looking at India?

India has a huge market with a huge potential; it is a very good time for investors to enter India, there is no doubt about that. You just need to understand the Indian consumer, how and what he buys, then you can succeed.

If we look at mistakes global companies have made, it is that they make global strategies and implement them in India, which don't always work. Indians expect all the quality expected worldwide, but at the Indian cost. Getting that balance is the main challenge.

Although we wouldn't say we have seen a direct impact of the Make in India campaign for a company already manufacturing in India, we have noticed that our customers have had a shift in mentality and now prefer to buy a product made in India instead of importing a more expensive product.

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