Company Flash

21 May 2007 | 6 pages

Everest Kanto Cylinder (EKCL.BO)

Buy: Strong 4Q Performance; Expansion Plans Announced

- 4Q results ahead of expectations — Net profit of Rs263m came in well ahead of expectations, driven by higher realizations and a lower than expected tax rate, and buoyed by trading income. The company also announced a 5:1 stock split.
- Realizations improve but margins down qoq — Average realizations (c.Rs8.7K/cyl) were up qoq (Rs8.3K/cyl in 3Q), driven by strong realizations at Dubai. However, EBITDA margins, though healthy at 25.6%, were down qoq due to adverse India sales mix (higher industrial: CNG sales) during 4Q.
- Announces further expansion plans... — EKC announced plans to invest US$60m for: (1) setting up a greenfield plant at Gandhidham in an SEZ to cater to the export demand from the Middle East (especially Iran), (2) expanding the existing Gandhidham plant to produce larger cylinders, targeted at the domestic OEM segment, and (3) de-bottlenecking the Tarapur plant to facilitate improvement in productivity.
- ...to be funded by equity-linked instruments — The expansions are proposed to be funded through the issue of equity-linked instruments, though further clarity on the same is yet to emerge. Resultant dilution, in our view, is likely to be ~5%.
- Reiterate Buy (1M) — The impact of the expansions is likely to be felt in FY09E, with FY08E to be largely unaffected. We, however, await further details before incorporating these into our estimates. EKC remains well positioned to benefit from the rapidly growing market for environment friendly CNG applications, both in India and globally. Maintain Buy/Medium risk with a TP of Rs1300.

Buy/Medium Risk	1M
Price (21 May 07)	Rs1,144.85
Target price	Rs1,300.00
Expected share price return	13.6%
Expected dividend yield	0.6%
Expected total return	**14.1%**
Market Cap	Rs22,350M
	US$555M

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	143	11.90	234.8	96.2	32.9	40.9	0.2
2006A	324	18.39	54.6	62.3	13.4	33.7	0.3
2007E	650	33.29	81.0	34.4	7.6	29.3	0.6
2008E	1,003	51.37	54.3	22.3	6.1	30.5	1.1
2009E	1,358	69.54	35.4	16.5	4.8	32.8	1.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 1. Everest Kanto – 4QFY07 Results (Rupees in Millions)

Year to 31 Mar	4QFY06	3QFY07	4QFY07	% yoy	Comments
Net Sales	**802**	**1,118**	**1,336**	**66.7%**	4Q includes trading income of c.Rs150m (c.Rs120m in 3Q)
(Increase)/decrease in stock in trade	24	(260)	102	335.9%	
Raw material consumed	465	874	644	38.6%	
Staff cost	32	37	44	38.2%	
Other expenses	124	148	203	63.4%	
Total expenditure	644	800	993	54.2%	
EBITDA	**157**	**318**	**343**	**117.5%**	
EBITDA margin	*19.6%*	*28.5%*	*25.6%*	*(282)*	qoq decline due to declining sales mix in India (higher industrial:CNG mix)
Interest	12	12	16	34.2%	
Depreciation	42	48	43	2.5%	
Other income	17	12	15	-9.8%	
Profit before tax	121	270	299	147.7%	
Tax	19	66	36	94.0%	
Tax rate	*15.4%*	*24.5%*	*12.1%*	*(1,247)*	Lower than expected due to higher contribution from Dubai
Profit after tax	**102**	**204**	**263**	**157.5%**	

Source: Company Reports and Citigroup Investment Research

Everest Kanto Cylinder

Company description

Everest Kanto Cylinder Limited (EKC) is the largest domestic manufacturer of high pressure gas cylinders used for the storage of industrial gases and CNG. While the first manufacturing facility (at Aurangabad) was set up in collaboration with Kanto Koatsu Yoki of Japan in 1978, the subsequent facilities have been built using in-house technology. The company currently has four manufacturing plants located in Aurangabad, Tarapur, Gandhidham, and Dubai with a total capacity to produce 706,000 cylinders per annum. An aggressive expansion plan including doubling of the Dubai capacity as well as a greenfield plant in China would see EKC's production capacity increase to 1.8m cylinders over the next 4-5 years.

Investment thesis

We rate the stock as Buy/Medium Risk (1M) with a target price of Rs1300. We believe EKC is uniquely positioned to capture the significant growth potential of the market for high pressure gas cylinders, driven largely by increasing CNG penetration both domestically and abroad. Increased production from new and existing plants amidst the current tightness in the cylinder market would see the company deliver EPS CAGR of 45% for FY07-09 on our estimates. EKC offers a unique opportunity for investors to participate in the back-end-enabling chain to service the rapidly expanding CNG market in India and overseas. While the CNG segment in India is still at a nascent stage of development vis-à-vis some other countries, cost economics, rising awareness, improving refueling infrastructure and visibility of gas supplies should see CNG penetration on an accelerating trajectory in India, thereby boosting demand for CNG cylinders. Coupled with the robust global outlook for natural gas-powered vehicles (population forecasted to increase to 50m by 2020, a CAGR of 17%) and a sanguine IP-linked growth outlook for industrial cylinders, we expect EKC's production to increase 2x over our forecast horizon.

Valuation

Our 12-month target price for EKC of Rs1300 is based on a target P/E multiple of 20x. We also roll forward earnings by three months, in line with target multiples of its manufacturing / engineering peers. We based our target on 12-month forward earnings (to Dec-08E) because we believe it better captures the contribution from China and full utilization of the Dubai facilities. In the absence of any direct listed comparables, either locally or globally, we prefer comparing EKC with capital goods companies that manufacture industrial goods that have a similar growth profile. EKC is also a leveraged play on the alternate energy/CNG theme with growth driven by cost economics and environmental concerns. Our target P/E is well supported by an EPS CAGR of 45% for FY07-09E. Although EKC is relatively small, we believe its valuations will closely track those of its peers given its exposure to the rapidly developing CNG market, for which there are only a few other plays available.

Risks

We assign a Medium Risk rating to EKC, rather than the High Risk rating as per our quantitative risk-rating system, as we think it is more appropriate given the secular nature of the business that the company operates in and the strong visibility of growth on increasing CNG penetration. The risk factor is further mitigated by the firm's low leverage and strong return parameters. Key downside risks to our target price: 1) Exposure to a single supplier - EKC's reliance on Tenaris for most of its raw material makes it vulnerable to the latter's pricing power; any unanticipated pricing action on the part of Tenaris could be a negative for EKC. However, EKC has in the past passed on cost increases to its customers. 2) China - is a hitherto unexplored market and EKC's entry there could incur teething troubles. 3) Competition - while the cylinder market in India has been relatively less exposed to competition, the low physical barriers to entry might lead to new players flooding the market, which might have an adverse impact on EKC's pricing power and hamper its ability to pass on cost increases to customers. 4) Crude prices - significantly lower crude prices could adversely impact CNG's strong economics and consequently slow CNG penetration. If any of these risk factors has a greater impact than we anticipate, the stock might have difficulty reaching our target price.

Appendix A-1

Analyst Certification

We, Saurabh Handa, Pradeep Mirchandani, CFA and Rahul Singh, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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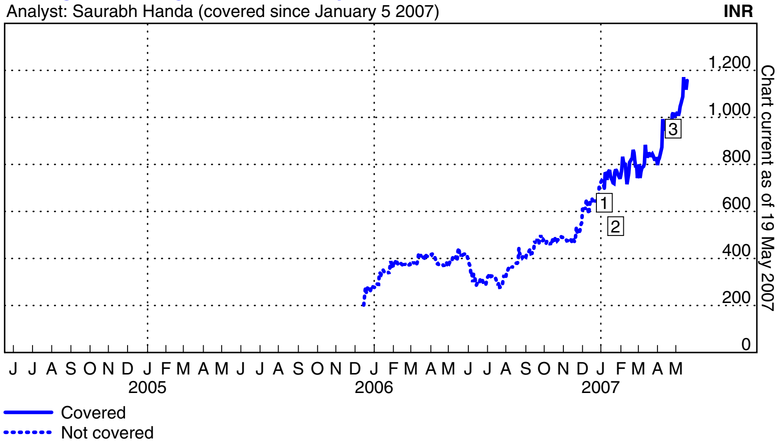
Everest Kanto Cylinder (EKCL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Saurabh Handa (covered since January 5 2007)



#	Date	Rating	Target Price	Closing Price
1:	5 Jan 07	1M	950.00	698.90
2:	24 Jan 07	1M	*990.00	778.20
3:	26 Apr 07	1M	*1,300.00	1,020.25

*Indicates change.

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