Company Focus

19 November 2007 | 15 pages

Everest Kanto Cylinder (EKCL.BO)

Target price change ☑
Estimate change ☑

Buy: Resuming Coverage; Increasing Target Price to Rs437

- **Raising TP to Rs437** — We resume coverage on EKC and increase our target price to Rs437 (Rs260 earlier) on the back of material new expansion plans announced over the last few months and capital raised to part-fund the same.
- **Well-timed expansions – positive and fully funded** — Besides the Dubai expansion (recently commenced) and China greenfield plant (to start next Q), EKC plans to: (1) expand the Gandhidham facility (0.2m industrial cyl/yr), (2) set up a greenfield plant at Kandla SEZ (0.3m CNG cyl/yr), and de-bottleneck Tarapur. Total capex envisaged is c.US$50m. The company has recently raised ~US$57m through an FCCB and private placement. We view the expansions as positive as they diversify two key risks – RM supplies and the China market.
- **Significant boost to earnings** — The new expansions are targeted at meeting the burgeoning domestic and global demand for CNG applications as well as producing value-added products such as jumbo cylinders which would add meaningfully to margins and, more importantly, address competitive pressures. Total capacity to grow 3x in 4-5 yrs from 0.8m/yr currently. We correspondingly adjust FY08E earnings by 3% and significantly revise FY09-10E by 18-33%.
- **Reiterate Buy (1M)** — Our new Rs437 TP implies 40% upside from current levels and is based on 22x Sep-09E earnings, well supported by 47% EPS CAGR over FY07-10E. EKC is well positioned to benefit from the rapidly growing global CNG market and is, in our view, one of the most leveraged plays to the expanding city gas distribution market in India.

Buy/Medium Risk	1M
Price (16 Nov 07)	Rs311.50
Target price	Rs437.00
from Rs260.00	
Expected share price return	40.3%
Expected dividend yield	0.5%
Expected total return	**40.8%**
Market Cap	Rs30,405M
	US$778M

Price Performance (RIC: EKCL.BO, BB: EKCL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	324	3.68	54.6	84.7	18.2	33.7	0.2
2007A	718	7.35	99.9	42.4	10.1	31.7	0.3
2008E	1,115	10.54	43.4	29.5	6.5	28.4	0.5
2009E	1,729	16.35	55.1	19.1	5.0	31.2	0.8
2010E	2,469	23.34	42.8	13.3	3.8	34.1	1.4

Source: Powered by dataCentral

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

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	84.7	42.4	29.5	19.1	13.3
EV/EBITDA adjusted (x)	52.4	27.0	19.2	12.6	9.1
P/BV (x)	18.2	10.1	6.5	5.0	3.8
Dividend yield (%)	0.2	0.3	0.5	0.8	1.4
Per Share Data (Rs)					
EPS adjusted	3.68	7.35	10.54	16.35	23.34
EPS reported	3.68	7.35	10.54	16.35	23.34
BVPS	17.13	30.98	47.75	61.84	81.11
DPS	0.70	1.00	1.65	2.56	4.39
Profit & Loss (RsM)					
Net sales	2,355	3,851	5,793	8,953	12,463
Operating expenses	-1,865	-2,884	-4,395	-6,763	-9,338
EBIT	**490**	**967**	**1,398**	**2,191**	**3,125**
Net interest expense	-37	-53	-102	-164	-198
Non-operating/exceptionals	22	40	115	108	84
Pre-tax profit	**476**	**953**	**1,411**	**2,135**	**3,011**
Tax	-141	-236	-296	-406	-542
Extraord./Min.Int./Pref.div.	-11	0	0	0	0
Reported net income	**324**	**718**	**1,115**	**1,729**	**2,469**
Adjusted earnings	324	718	1,115	1,729	2,469
Adjusted EBITDA	588	1,145	1,646	2,605	3,655
Growth Rates (%)					
Sales	77.9	63.5	50.4	54.6	39.2
EBIT adjusted	133.9	97.2	44.6	56.7	42.6
EBITDA adjusted	104.2	94.7	43.8	58.2	40.3
EPS adjusted	54.6	99.9	43.4	55.1	42.8
Cash Flow (RsM)					
Operating cash flow	**300**	**-182**	**679**	**881**	**1,722**
Depreciation/amortization	98	178	248	414	530
Net working capital	-122	-1,078	-684	-1,262	-1,278
Investing cash flow	**-591**	**-717**	**-2,561**	**-1,412**	**-612**
Capital expenditure	-591	-717	-2,561	-1,412	-612
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**667**	**1,091**	**2,965**	**238**	**-525**
Borrowings	-93	307	2,255	531	-3
Dividends paid	-70	-114	-196	-303	-520
Change in cash	**376**	**192**	**1,083**	**-293**	**584**
Balance Sheet (RsM)					
Total assets	**2,514**	**4,718**	**8,878**	**11,377**	**14,011**
Cash & cash equivalent	290	471	1,554	1,261	1,845
Accounts receivable	234	575	878	1,357	1,889
Net fixed assets	939	1,478	3,792	4,790	4,871
Total liabilities	**1,004**	**1,704**	**4,047**	**5,121**	**5,806**
Accounts payable	266	379	578	893	1,244
Total Debt	395	702	2,957	3,488	3,485
Shareholders' funds	**1,509**	**3,024**	**4,830**	**6,256**	**8,205**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	25.0	29.7	28.4	29.1	29.3
ROE adjusted	33.7	31.7	28.4	31.2	34.1
ROIC adjusted	24.8	26.3	21.3	22.7	26.0
Net debt to equity	7.0	7.6	29.0	35.6	20.0
Total debt to capital	20.7	18.8	38.0	35.8	29.8

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Digesting the New Expansion Plans

In May 2007, EKC announced new expansion plans over and above the Dubai expansion (commenced production in Sep-07, capacity up from 96K to 196K CNG cyl/yr) and the new China plant (1m cyl/yr, production likely to commence in 4QFY08E). The new expansion plans are explained in detail below:

1. **Gandhidham expansion:** Besides the existing 340K cyl/yr plant at Gandhidham (currently running at 60%+ utilization), EKC now plans to expand this facility to produce industrial cylinders through the billet piercing route with a total capacity of 0.2m cyl/yr. The rationale is two-fold:

    - The raw materials (billets) are c.10% cheaper than seamless tubes and also readily available locally, hence reducing dependence on seamless tube imports (a major portion being sourced from Tenaris)

    - Despite higher operating costs, total cost of production is expected to be slightly lower than for cylinders manufactured through hot spinning (i.e. using tubes), hence affording EKC the flexibility to price these products competitively

2. **Capacity for jumbo cylinders:** EKC will also set up a separate line for producing 5,000 jumbo cylinders per year (large cylinders with a total weight of c.1,600kg/cyl) at the existing Gandhidham plant. While this line would initially cater to the Rs400m defence order that the company announced in Jan-07, these cylinders would also find application in transportation of gas over longer distances by gas distribution companies. City gas distribution in India is set to take off in a big way, propelled by increased supplies, improving transmission and distribution infrastructure, cost economics, and environmental benefits. Estimates have pegged the number of cities under the CGD ambit increasing to anywhere between 40 and 200 over the next 5-10 years (from 10 cities currently)[1]. Since India is a relatively under-developed gas economy, use of jumbo cylinders will find particular use in transportation of gas to areas where setting up of dedicated infrastructure may be uneconomical or at best, some time away.

3. **New SEZ plant:** EKC also plans to set up a new greenfield plant in an SEZ in Kandla (~30km from the existing Gandhidham plant). This plant would primarily be an export-oriented unit with a capacity to produce 0.3m CNG cylinders per year from steel plates, targeted primarily at OEMs in Europe, Iran, and Pakistan. The rationale is two-fold:

    - Steel plates are cheaper than seamless tubes and also easily available from domestic manufacturers.

    - Cylinders thus produced have a lower weight to volume ratio than those produced through the traditional method, which would help EKC target OEMs that typically have a preference for such products (also possibly look at new markets like Europe), improving realizations in the process.

[1] Refer to our report titled 'India Natural Gas – Gas the Way to Go' dated 12 September 2007 for a more detailed discussion of the same. The report may be accessed at: https://www.citigroupgeo.com/pdf/SAP09180.pdf

Figure 1. EKC's new expansion plans

Type of cylinders	RM used	Location	Capacity ('000 cyl/yr)	Expected commissioning	Capex (Rs m)
Industrial cylinders	Billets	Gandhidham	200	Apr-08E	600
Jumbo cylinders	Seamless tubes	Gandhidham	5	Apr-08E	
CNG cylinders	Steel plates	Kandla SEZ	300	Dec-08E	1220

Source: Company Reports and Citi Investment Research

Derisking the business model; moving into a different league

With these announcements, EKC would not only move into a different league globally in terms of scale, but more importantly, has addressed two key risks which have been of primary concern to us – the China market and raw material availability – as explained below.

1. The expansions would enable EKC to derisk its business model by expanding its presence in geographies (esp. Middle East, Pakistan) and with customers (esp. OEMs in Middle East, Pakistan, India) it is more familiar with, relatively reducing its dependence on success of its China venture, a hitherto unexplored market that poses the highest risk to EKC, in our view.

2. Diversification of raw materials (billets, plates) also reduces its exposure to a single supplier (Tenaris), making it less vulnerable to the latter's pricing power, besides having a positive impact on margins.

3. Flexibility to price products such as industrial cylinders (produced via the billet piercing route) more competitively without compromising on margins.

4. Entry into new value-added segments such as jumbo cylinders where EKC is likely to have a clear competitive advantage.

5. The expansions would take EKC into a wholly different league and make it one of the largest global manufacturers of high pressure gas cylinders, enabling it to benefit strongly in a market marked by increasing tightness as well as entering new, lucrative markets such as Western Europe.

New target price of Rs437

- We increase our target price to Rs437 from Rs260 earlier on the back of our earnings upgrade and also as we roll forward our target multiple to Sep-09E from Dec-08E earlier.

- We base our target price on a 22x target P/E multiple (20x earlier), which is at a reasonable discount to peer multiples (in the 23-30x range, as shown in Figure 2 below). We prefer comparing EKC with capital goods companies that manufacture industrial goods and have a similar growth profile. EKC is also an indirect play on the alternate energy theme with growth driven by cost economics and environmental concerns. Despite similar earnings growth profile, we value EKC at a discount to its peers' target multiples (vs. in line earlier) to factor in the difference in the nature of businesses and also the higher order book visibility of the capital goods companies which are direct beneficiaries of rising infrastructure capex in India.

- Our target P/E is well supported by an EPS CAGR of 47% for FY07-10E and healthy capital return ratios. 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.

Figure 2. Peer group target price multiples

	RIC Code	Price 16-Nov-07	M-cap US$m	Rating	Target Price	Target PE (x)	Target PE Basis	EPS CAGR FY07-10E	Target P/BV[2]	ROE FY09E
Suzlon Energy	SUZL.BO	2,065	15,221	1L	2,227	26.0[1]	Sep-09E	48.6%	9.6	36.6%
Punj Lloyd	PUJL.BO	501	3,807	1L	593	25.0[1]	Sep-09E	55.0%	5.6	21.8%
BHEL	BHEL.BO	2,787	34,909	1L	2,542	26.0	Sep-09E	30.2%	8.5	32.7%
Larsen & Toubro	LART.BO	4,376	32,612	3L	4,010	30.0[1]	Sep-09E	41.0%	11.7	33.7%
Thermax	THMX.BO	880	2,683	1L	764	23.0	Mar-09E	35.6%	8.2	41.4%
Average						**26.8**		**42.1%**	**8.7**	**33.3%**
Everest Kanto	EKCL.BO	312	778	1M	437	22.0	Sep-09E	47.0%	7.1	31.2%

Source: Citi Investment Research estimates. [1]Target PE on core earnings. [2]Target FY09E P/BV.

On our target price, EKC would trade at a P/BV of 7.1x for FY09E, a discount to the target P/BV of the peers, despite similar return parameters, as shown in Figure 2.

Earnings upgrade drives 3-yr EPS CAGR of 47%

On our revised estimates, we now expect EKC to grow EPS at a CAGR of 47% over FY07-10E, broadly tracking sales CAGR of 48% over the same period.

The key changes to our earnings and key assumptions are summarized in Figure 3 below:

Figure 3. EKC – Key Revisions

	Total production ('000 cylinders)		Average realization (Rs/cyl)		EBITDA Margin (%)		EBITDA (Rs m)			EPS (Rs)		
Year to 31-Mar	Old	New	Old	New	Old	New	Old	New	% change	Old	New	% change
2008E	666	687	9,029	8,435	27.4%	28.4%	1,649	1,646	-0.2%	10.27	10.54	2.7%
2009E	988	1,034	8,590	8,657	25.9%	29.1%	2,196	2,605	18.6%	13.81	16.35	18.4%
2010E	1,257	1,411	7,952	8,834	26.7%	29.3%	2,665	3,655	37.2%	17.55	23.34	33.0%

Source: Citi Investment Research estimates

We adjust our FY08E earnings by 3% primarily to factor in 1HFY08 performance and slightly better than expected operating margins. We are significantly increasing our FY09-10E earnings by 18-33% on the back of the following:

1. Incorporation of production from the new capacities (Gandhidham billet piercing + jumbo cylinders facility to start producing in 1QFY09E, Kandla SEZ to start producing in 4QFY09E, a separate line for jumbo cylinders in the China plant to start producing in 4QFY09E). Total cylinder production in FY10E consequently increases from our earlier assumption of 1.26m to 1.41m, nearly trebling over FY07-10E.

2. Changes to our cost and margin assumptions are driven by:

   - Lower average raw material costs, partially mitigated by higher operating costs, for the two new plants using billets and steel plates

   - Higher margins for jumbo cylinders which are high value add products

   The result is an increase in our EBITDA margin forecasts over FY08-10E from the 26-27% range earlier to 28-29% levels (average margins were 29% in 1HFY08), which we believe is attainable given the better product mix and better raw material sourcing ability and aided by the continued robust demand for the company products.

3. Changes to our tax rate assumptions as, besides the Dubai and China plants, the Kandla SEZ plant would also benefit from tax incentives

4. Incorporation of additional capex of US$50m to be incurred over FY08-09E for the new expansions – total capex assumed over the next five years equals US$135m.

Our revised FY08-10E EPS numbers are now fully diluted for the impact of the FCCB issued (US$35m) and the preferential allotment of shares to TVG Capital Partners (Rs800m) and CLSA (Rs87m). The total US$57m of capital raised results in a dilution of ~8%.

Figure 4 below illustrates in detail changes to our utilization and production assumptions by plant:

Figure 4. EKC – changes to plant-wise capacity utilization and production assumptions

Year to 31-Mar	Old			New		
(no. of cylinders)	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Aurangabad						
CNG production	-	-	-	-	-	-
Industrial production	115,500	115,500	115,500	121,000	121,000	121,000
Total production	115,500	115,500	115,500	121,000	121,000	121,000
Capacity	110,000	110,000	110,000	110,000	110,000	110,000
Capacity utilization	*105.0%*	*105.0%*	*105.0%*	*110.0%*	*110.0%*	*110.0%*
Tarapur						
CNG production	88,000	91,200	105,600	92,400	97,584	105,600
Industrial production	72,000	68,800	70,400	75,600	73,616	70,400
Total production	160,000	160,000	176,000	168,000	171,200	176,000
Capacity	160,000	160,000	160,000	160,000	160,000	160,000
Capacity utilization	*100.0%*	*100.0%*	*110.0%*	*105.0%*	*107.0%*	*110.0%*
Dubai						
CNG production	156,800	196,000	215,600	156,800	196,000	205,800
Industrial production	-	-	-	-	-	-
Total production	156,800	196,000	215,600	156,800	196,000	205,800
Capacity	196,000	196,000	196,000	196,000	196,000	196,000
Capacity utilization	*80.0%*	*100.0%*	*110.0%*	*80.0%*	*100.0%*	*105.0%*
Gandhidham						
CNG production	122,400	192,780	221,000	132,600	187,850	226,100
Industrial production	81,600	113,220	119,000	88,400	101,150	96,900
Total production	204,000	306,000	340,000	221,000	289,000	323,000
Capacity	340,000	340,000	340,000	340,000	340,000	340,000
Capacity utilization	*60.0%*	*90.0%*	*100.0%*	*65.0%*	*85.0%*	*95.0%*
Gandhidham (new - billet piercing)						
Total production (only industrial)	-	-	-	-	100,000	150,000
Capacity	-	-	-	-	200,000	200,000
Capacity utilization	-	-	-	-	*50.0%*	*75.0%*
Gandhidham (new - jumbo)						
Total production (only jumbo)	-	-	-	-	1,500	3,500
Capacity	-	-	-	-	5,000	5,000
Capacity utilization	-	-	-	-	*30.0%*	*70.0%*
Kandla (new - SEZ)						
Total production (only CNG)	-	-	-	-	15,000	180,000
Capacity	-	-	-	-	300,000	300,000
Capacity utilization	-	-	-	-	*5.0%*	*60.0%*
China						
CNG production	30,000	136,500	266,500	20,000	112,000	125,000
Industrial production	-	73,500	143,500	-	28,000	125,000
Total production	30,000	210,000	410,000	20,000	140,000	250,000
Capacity	200,000	400,000	700,000	200,000	200,000	500,000
Capacity utilization	*15.0%*	*52.5%*	*58.6%*	*10.0%*	*70.0%*	*50.0%*
China (jumbo)						
Total production (only jumbo)	-	-	-	-	500	1,500
Capacity	-	-	-	-	5,000	5,000
Capacity utilization	-	-	-	-	*10.0%*	*30.0%*
TOTAL						
CNG production	397,200	616,480	808,700	401,800	608,434	842,500
Industrial production	269,100	371,020	448,400	285,000	423,766	563,300
Jumbo production				-	2,000	5,000
Total production	**666,300**	**987,500**	**1,257,100**	**686,800**	**1,034,200**	**1,410,800**
Capacity	**1,006,000**	**1,206,000**	**1,506,000**	**1,006,000**	**1,516,000**	**1,816,000**
Capacity utilization	***66.2%***	***81.9%***	***83.5%***	***68.3%***	***68.2%***	***77.7%***

Source: Company Reports and Citi Investment Research estimates

Summary financials

Figure 5. EKC – Consolidated Income Statement (Rupees in Millions)

Year to 31-Mar	FY06	FY07	FY08E	FY09E	FY10E
Income					
Net sales	2,355	3,794	5,793	8,953	12,463
Products traded	-	57	-	-	-
Total operating income	**2,355**	**3,851**	**5,793**	**8,953**	**12,463**
Realization (Rs/cyl)	*6,523*	*8,032*	*8,435*	*8,657*	*8,834*
% yoy	*77.9%*	*63.5%*	*50.4%*	*54.6%*	*39.2%*
Expenditure					
Raw materials & goods consumed	1,306	2,282	3,119	4,865	6,619
RM cost as a % of sales	*55.4%*	*59.3%*	*53.8%*	*54.3%*	*53.1%*
(Increase)/decrease in inventory	(2)	(336)	(20)	(30)	(30)
Staff costs	89	144	209	293	439
% yoy	*34.6%*	*61.2%*	*45.0%*	*40.0%*	*50.0%*
Operating expenses	238	377	567	908	1,436
as a % of sales	*10.1%*	*9.8%*	*9.8%*	*10.1%*	*11.5%*
Admin, sales, & other expenses	136	240	272	313	344
Total expenditure	**1,767**	**2,706**	**4,147**	**6,349**	**8,808**
EBITDA	**588**	**1,145**	**1,646**	**2,605**	**3,655**
EBITDA margin	*25.0%*	*29.7%*	*28.4%*	*29.1%*	*29.3%*
Interest	37	53	102	164	198
Depreciation	98	178	248	414	530
Other income	22	40	115	108	84
Profit before tax	476	953	1,411	2,135	3,011
Provision for tax	141	236	296	406	542
Tax rate	*29.6%*	*24.7%*	*21.0%*	*19.0%*	*18.0%*
Profit after tax	**335**	**718**	**1,115**	**1,729**	**2,469**
Net income margin	*14.2%*	*18.6%*	*19.2%*	*19.3%*	*19.8%*
% yoy growth	*134.6%*	*114.2%*	*55.4%*	*55.1%*	*42.8%*

Source: Company Reports and Citi Investment Research estimates

Figure 6. EKC – Consolidated Balance Sheet (Rupees in Millions)

Year to 31-Mar	**FY06**	**FY07**	**FY08E**	**FY09E**	**FY10E**
Gross block	1,571	1,958	3,153	5,165	6,577
Less: depreciation	636	814	1,062	1,475	2,006
Net block	935	1,144	2,092	3,690	4,571
Add: CWIP	5	335	1,700	1,100	300
Net block after adjustments	**939**	**1,478**	**3,792**	**4,790**	**4,871**
Investments	132	134	134	134	134
Cash/bank	290	471	1,554	1,261	1,845
Net Current Assets	**557**	**1,634**	**2,318**	**3,580**	**4,858**
Current assets	1,152	2,636	3,398	5,192	7,161
- Inventories	423	1,144	1,747	2,700	3,759
- Receivables	234	575	878	1,357	1,889
- Loans & advances	495	917	773	1,135	1,513
Current liabilities	596	1,001	1,080	1,612	2,303
- Creditors	266	379	578	893	1,244
- Provisions	330	623	502	719	1,059
Misc exp not w/o	-	9	-	-	-
Total Assets	**1,918**	**3,726**	**7,798**	**9,764**	**11,708**
Share capital	176	195	202	202	202
Reserves & surplus	1,333	2,829	4,628	6,053	8,003
Total Networth	**1,509**	**3,024**	**4,830**	**6,256**	**8,205**
Borrowings	**395**	**702**	**2,957**	**3,488**	**3,485**
Long-term	307	628	793	1,104	901
Short-term	88	74	764	984	1,184
FCCB			1,400	1,400	1,400
Debt/Equity	*26.2%*	*23.2%*	*61.2%*	*55.8%*	*42.5%*
Debt (ex-FCCB)/Equity	*26.2%*	*23.2%*	*32.2%*	*33.4%*	*25.4%*
Deferred tax liability	14	0	10	20	18
Total Liabilities	**1,918**	**3,726**	**7,798**	**9,764**	**11,708**

Source: Company Reports and Citi Investment Research estimates

Figure 7. EKC – Consolidated Cash Flow Statement (Rupees in Millions)

Year to 31-Mar	**FY06**	**FY07**	**FY08E**	**FY09E**	**FY10E**
Net income	324	718	1,115	1,729	2,469
Deprec., amort.	98	178	248	414	530
Net change in WC	(122)	(1,078)	(684)	(1,262)	(1,278)
Cash from ops.	**300**	**(182)**	**679**	**881**	**1,722**
Capital expenditure	(591)	(717)	(2,561)	(1,412)	(612)
Cash from investing	(591)	(717)	(2,561)	(1,412)	(612)
Change in borrowings	**(93)**	**307**	**2,255**	**531**	**(3)**
Equity raised	844	920	887	-	-
Dividends paid	(70)	(114)	(196)	(303)	(520)
Other financing	(13)	(22)	19	10	(3)
Cash from financing	**667**	**1,091**	**2,965**	**238**	**(525)**
Net cash flow	**376**	**192**	**1,083**	**(293)**	**584**

Source: Company Reports and Citi Investment Research estimates

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 806,000 cylinders per year. An aggressive expansion plan including a greenfield plant in China, expansion of the Gandhidham facility, and a new plant in an SEZ would see EKC's production capacity increase to 2.3m cylinders over the next 4-5 years.

Investment strategy

We rate the stock as Buy/Medium Risk (1M) with a target price of Rs437. 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 47% for FY07-10 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 city gas distribution and consequently 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 treble over FY07-10E.

Valuation

Our 12-month target price for EKC of Rs437 is based on a target P/E multiple of 22x Sep-09E earnings. Our multiple is at a reasonable discount to target multiples of its manufacturing / engineering peers which are in the 23-30x range. We base our target on mid-FY09E earnings because we believe it better captures the contribution from China, full utilization of Dubai, and part contribution from the newly announced expansions. We prefer comparing EKC with capital goods companies that manufacture industrial goods that have a similar growth profile. However, given the difference in the nature of the business and the higher order book visibility of these companies, we believe EKC should trade at a discount to its peers. EKC is also a material play on the alternate energy/CNG theme and one of the most leveraged plays to the expanding city gas distribution market in India. Our target P/E is well supported by an EPS CAGR of 47% for FY07-10E. 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. Besides, the new expansions would further mitigate this risk with EKC diversifying towards more easily available raw materials. 2) China – a hitherto unexplored market, 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 have led to some players entering the market in the recent past, which might have an adverse impact on EKC's pricing power and hamper its ability to pass on cost increases to customers. 4) Project risk – EKC is implementing significant expansion plans that are subject to time and cost over-runs that could adversely impact earnings. 5) 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

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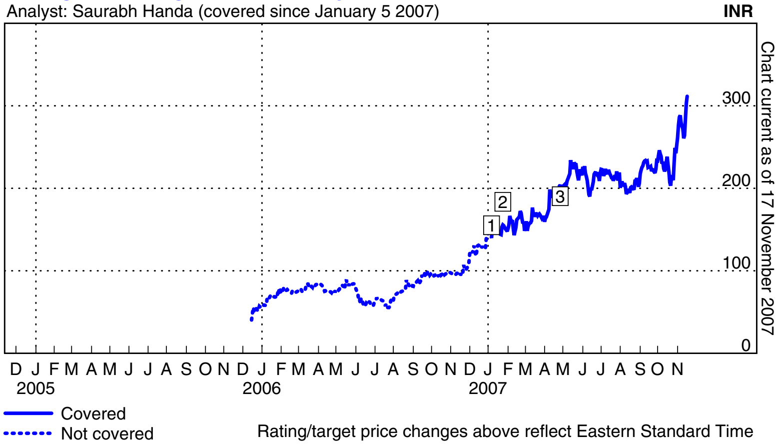
IMPORTANT DISCLOSURES

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	190.00	139.78
2:	24 Jan 07	1M	*198.00	155.64
3:	26 Apr 07	1M	*260.00	204.05

*Indicates change.

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