Company Flash

11 March 2008 | 7 pages

Everest Kanto Cylinder (EKCL.BO)

Meeting with management ☑
Conference ☑

Citi India Conference 2008: Day 1 Takeaways

- **Conference takeaways** — Everest Kanto spoke with investors at the Citi India Investor Conference 2008. Here are some of the highlights of that presentation.

- **Robust industry outlook reiterated** — Management stated that the growth outlook for CNG cylinders remains extremely robust, especially in the Middle East and South East Asia. CNG vehicle population is expected to grow by ~800K vehicles/yr in Iran, ~250K/yr in Pakistan, and ~200K/yr (combined) in other countries such as Thailand, Malaysia, Philippines, Indonesia, etc. The Indian market also looks set for rapid growth with increased gas supplies from recent discoveries resulting in ~46 cities under the CNG net over the next few years (~10 currently). The Indian CNG vehicle population is estimated to increase to ~1m by 2011 (~0.4m currently). In China, the number of CNG stations is expected to increase to 1846 by 2010 from 260 currently, contributing to rapid growth there.

- **Expansion plans on track** — The China plant, with an initial capacity of 215K cyl/yr + a line for jumbo cylinders, is expected to go into commercial production this month (trial production already commenced). The billet piercing plant at Gandhidham (200K industrial cyl/yr) and the jumbo cylinder plant at Gandhidham (5K cyl/yr) are expected to be commissioned by 3QFY09. Construction work for the greenfield plant at Kandla SEZ (300K CNG cyl/yr) is in progress and the plant is likely to be operational by 4QFY09.

- *(see next page for more bullets)*

Buy/Medium Risk	**1M**
Price (11 Mar 08)	Rs292.75
Target price	Rs437.00
Expected share price return	49.3%
Expected dividend yield	0.6%
Expected total return	**49.9%**
Market Cap	Rs29,614M
	US$733M

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	79.6	17.1	33.7	0.2
2007A	718	7.35	99.9	39.8	9.4	31.7	0.3
2008E	1,115	10.54	43.4	27.8	6.1	28.4	0.6
2009E	1,748	16.53	56.8	17.7	4.7	31.5	0.9
2010E	2,492	23.56	42.5	12.4	3.6	34.4	1.5

Source: Powered by dataCentral

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

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- **Acquisition of CPI; good facility, significant market share…** – Management gave a few more details on the proposed acquisition of the vessel manufacturing facilities of CP Industries (CPI), USA for a total of US$64m. The deal is expected to be completed by Apr-08 subject to court and other regulatory approvals. CPI manufactures large seamless vessels for the transportation and storage of pressurized gases. The products are compliant with various agencies and bodies such as ASME (American Society of Mechanical Engineers), US Dept of Transportation, US govt., NASA, Transport Canada, China govt., and ISO (recognized by all members of the EU). Based on 2007 sales, CPI had a global market share of 43% in the large vessel segment (total industry sales of c.US$93m).

- **…along with strong customer base, robust operating performance** – CPI's key customers include US and international companies such as Weldship, Praxair, Chesterfield, BOC Air Products, Air Liquide, and JB Kelley, amongst others. CPI has 118 employees, one manufacturing facility in US, and one representative office in Beijing. In CY07, it had sales of US$41m (80% in US) and EBITDA of US$9.3m (23% margin) at a (sub-optimal) capacity utilization of 65-70%. Operating margins have increased from 15% to 23% over the last few years driven by a better sales mix and product price hikes; management stated that CPI has a dominant position in the industry, enabling it to pass on input cost increases to their customers.

Everest Kanto Cylinder

Company description

Everest Kanto Cylinder (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, subsequent facilities have been built using in-house technology. The company currently has four manufacturing plants -- in Aurangabad, Tarapur, Gandhidham, and Dubai -- that have a total production capacity of 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 increase EKC's capacity 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. While the CNG segment in India is still at a relatively nascent stage, cost economics, improving refueling infrastructure and visibility of gas supplies should mean an accelerating trajectory for city gas distribution and consequently CNG penetration, thereby boosting demand for CNG cylinders. Coupled with the robust global outlook for natural gas-powered vehicles and a sanguine IP-linked growth outlook for industrial cylinders, we expect EKC's production to increase ~3x over FY07-10E.

Valuation

Our 12-month target price for EKC of Rs437 is based on 22x Sep09E earnings, representing a discount to fair-value multiples of 23-30x for its manufacturing / engineering peers in India. We base our target multiple 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 leveraged play on the alternative 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.

Risks

We assign a Medium Risk rating to EKC shares, rather than the High Risk rating as per our quantitative risk-rating system, given the strong visibility of growth on increasing CNG penetration. Key downside risks to our target price include: 1) Exposure to a single supplier – EKC's reliance on Tenaris for most of its raw materiasl makes it vulnerable to the latter's pricing power. 2) China – a hitherto unexplored market, with the risk that EKC's entry there could incur teething troubles. 3) Competition – low physical barriers to entry have led to some players entering the market in the recent past, which might adversely impact EKC's pricing power. 4) Project risk – EKC is implementing significant expansion plans that are subject to time and cost over-runs. 5) Crude prices – significantly lower crude prices could adversely impact CNG's strong economics and consequently slow CNG penetration.

Appendix A-1

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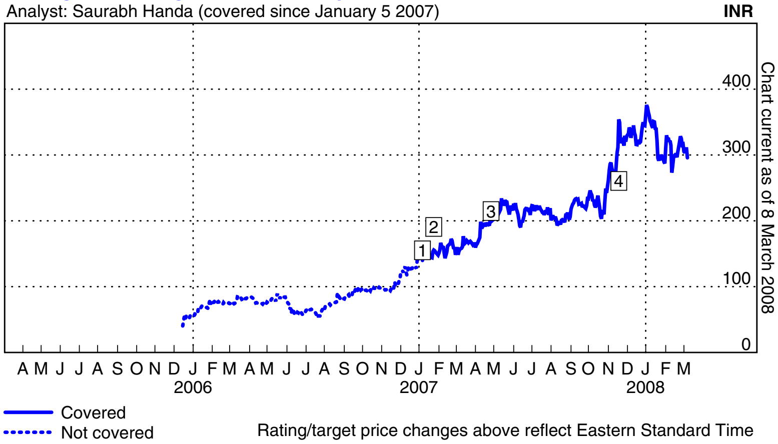
Ratings and Target Price History - Fundamental Research
Analyst: Saurabh Handa (covered since January 5 2007)



#	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
4:	19 Nov 07	1M	*437.00	354.10

*Indicates change.

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