



Everest Kanto Cylinders

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,976	EKCL IN
	REUTERS CODE
S&P CNX: 5,932	EKCL.BO

2 November 2007

Buy

Previous Recommendation: Buy

Rs277

Equity shares (m)	97.6	YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
52-Week Range	279/91	END	(RS M)	(RS M)	(RS)	YoY (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
1, 6, 12 Rel. Perf. (%)	0/-7/133	03/07A	4,251	718	7.4	95.5	37.7	8.9	31.7	34.4	6.0	23.7
M. Cap. (Rs b)	27.0	03/08E	5,858	1,148	11.4	54.4	24.4	5.8	29.1	29.1	4.6	16.8
M. Cap. (US\$ b)	0.7	03/09E	8,419	1,659	15.7	38.2	17.7	3.8	26.6	29.2	3.3	11.8

- 2Q margins better than expected:** Everest Kanto's sales for 2QFY08 are in line with estimates at Rs1.3b, up 27.6% YoY. However, EBITDA margin is up 470bps YoY at 31% (expected 26.4%). As a result, EBITDA is up 51% YoY at Rs397m (expected Rs344m). Adjusted for Rs12m profit on sale of investments, PAT is up 100% YoY at Rs272m (expected Rs229m). The major reasons for higher margin are: (1) product mix in favour of CNG cylinders, and (2) low-cost inventory of seamless tubes, stocked up in FY07.
- 2nd unit at Dubai commissioned, China and India plans on schedule:** In October, EKCL commissioned its 2nd Dubai unit with a capacity of 100,000 cylinders. The China venture is on schedule with Phase 1 of 200,000 units expected to commission in 4QFY08. Expansion plans at Gandhidham (billet-piercing technology and jumbo cylinders) are also on schedule to be commenced by March 2008.
- EPS upgraded: 17% for FY08E and 14% for FY09E:** Everest Kanto is confident of maintaining 28-29% EBITDA margin, against our earlier estimate of 26.5%. Factoring in higher margins, our FY08E EPS estimate is 17% higher at Rs11.4 (up 54% YoY) and FY09E EPS up 14% at Rs15.7, up 38% YoY. EPS CAGR FY07-10 is a healthy 46%.
- Premium valuation justified; target price Rs314; maintain Buy:** The stock is trading at a PE of 24x FY08E and 18x FY09E. We believe EKCL will enjoy premium valuation due to high earnings growth, coupled with 25%+ RoE and near zero debt. We value the stock at 20x FY09E EPS to arrive at a target of Rs314, 13% upside from current levels. We believe there is room for earnings upgrade and valuation re-rating. We maintain **Buy**.

QUARTERLY PERFORMANCE - CONSOLIDATED

(RS Million)

	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Income	796	1,001	1,118	1,336	1,113	1,277	1,509	1,959	4,251	5,858
Change (%)	97.6	74.4	93.8	66.7	39.9	27.6	35.0	46.6	80.5	37.8
Total Expenses	575	738	800	994	805	881	1,079	1,395	3,106	4,160
EBITDA	221	263	318	343	309	397	430	564	1,145	1,699
Change (%)	116.7	60.6	98.9	110.3	39.6	50.8	35.1	64.5	94.5	48.4
EBITDA Margin (%)	27.8	26.3	28.5	25.6	27.7	31.0	28.5	28.8	26.9	29.0
Depreciation	42	44	48	43	43	49	62	85	178	239
Interest	9	17	12	16	16	26	23	29	53	94
Other Income	6	6	12	15	9	19	9	13	40	50
Extraordinary inc/ (exp)	0	0	0	0	0	12	0	0	0	0
PBT	176	208	270	299	259	353	354	462	953	1,416
Tax	62	72	66	36	36	69	67	82	236	255
Tax/PBT (%)	35.0	34.6	24.5	12.1	14.0	19.6	19.0	17.8	24.7	18.0
PAT	115	136	204	263	223	284	287	380	718	1,161
Adjusted PAT	115	136	204	263	223	272	287	380	718	1,161
Change (%)	144.6	45.9	133.4	144.6	94.0	99.6	40.9	44.4	114.2	61.8
PAT Margin (%)	14.4	13.6	18.2	19.7	20.0	21.3	19.0	19.4	16.9	19.8

E: MOST Estimates

2Q margins better than expected

Everest Kanto's sales for 2QFY08 are in line with estimates at Rs1.3b, up 27.6% YoY. However, EBITDA margin is up 470bps YoY at 31% (expected 26.4%). As a result, EBITDA is up 51% YoY at Rs397m (expected Rs344m). Adjusted for Rs12m profit on sale of investments, PAT is up 100% YoY at Rs272m (expected Rs229m).

The major reasons for higher margin are:

- (1) product mix in favour of CNG cylinders, and
- (2) low-cost inventory of seamless tubes, stocked up in FY07.

Product mix in favour of CNG cylinders: During the quarter, EKCL sold about 164,000 cylinders, up 15% YoY. The product mix also improved – 68:32 in favour of CNG cylinders over industrial cylinders (vs 62:38 in FY07). CNG cylinders have an average unit realization of about Rs11,000 compared to Rs3,500 for industrial cylinders, and are also more profitable.

Low-cost inventory of seamless tubes: In FY07, Everest Kanto expected to ramp up its production at Gandhidham higher than the achieved 33%. Also, it expected to commission its 2nd unit in Dubai in early FY08. In anticipation of both these, the company had procured its raw materials, mainly seamless tubes.

However, Gandhidham production was lower than expected, and the Dubai unit also got delayed due to non availability of power. Thus, the seamless tubes inventory which was procured at lower cost than current got consumed in 1HFY08, helping margin improvement.

2nd unit at Dubai commissioned; China, India plans on track

In October, EKCL commissioned its 2nd Dubai unit with a capacity of 100,000 CNG cylinders. It expects 30-35,000 cylinders from this unit for the rest of FY08, against our estimate of 15,000.

The China venture is on schedule with Phase 1 of 200,000 units expected to commission in 4QFY08. Expansion plans in India are also on schedule:

- ✂ **At Gandhidham:** 200,000 industrial cylinders using billet-piercing technology, and 5,000 jumbo cylinders
- ✂ **At Kandla SEZ:** 300,000 CNG cylinders using steel plates (rather than seamless tubes).

EVEREST KANTO'S CURRENTLY PLANNED EXPANSION

EXPANSION	TIME FRAME	COST (US\$ M)
China:		
✂ Phase 1: 200,000 to 1m cylinders	FY09-11	50
✂ Phase 2: 1m to 1.5m cylinders	FY12-13	25
India:		
✂ 200,000 industrial cylinders using billet piercing technology	Mar-08	10
✂ 5,000 jumbo cylinders	Mar-08	5
✂ 300,000 CNG cylinders based on deep drawn technology using steel plates	Mar-09	35
Total		125

Source: Company/Motilal Oswal Securities

US\$57.5m equity funding completed

Everest Kanto's total expansion plan is at US\$125m – US\$75m in China and US\$50m in Gandhidham. To part finance the same, the company raised US\$57.5 million recently, by way of a US\$35m FCCB issue and a preferential equity issue of US\$22.5m. The total equity dilution is expected to be about 8%, and the final equity at 105.7m shares of Rs2 each.

US\$35m FCCB issue: In October 2007, Everest Kanto completed its issue of zero-coupon, 7.25% YTM, 5-year FCCBs, convertible into 4.6m shares at Rs303.36. The bonds carry a reset clause which gets triggered on October 9, 2008. Under this clause, if the average price for 20 days before that date is lower than the initial conversion price of Rs303.36, the price shall be reset to the prevailing price or Rs257.85 (85% of initial conversion price), whichever is higher.

US\$22.5m preferential equity issue: In October 2007, Everest Kanto raised Rs887m (US\$22.5m) via a preferential issue of 3.55m equity shares at Rs250 per share. The company issued 3.2m shares to TVG India, an

international private equity fund, and 0.35m shares to M/s Brightwill (subsidiary of a fund managed by CLSA Private Equity). The shares are subject to a lock-in of one year in accordance with SEBI guidelines.

EPS upgraded: 17% for FY08E, 14% for FY09E

The demand environment remains strong, and the company's capacity is sold out for the next two years at least. The company is confident of maintaining 28-29% EBITDA margin. This may improve after commissioning of the China unit which will source seamless tubes locally. (Units in India and Dubai mainly buy seamless tubes from Tenaris, Luxemburg.)

Our sales estimate is revised upwards by a marginal 3% for FY08E, and remains almost unchanged for FY09E. We have upgraded margins by 250bps to 29% for FY08E and by 300bps to 29.5% for FY09E, in line with company guidance.

As a result, our FY08E EPS estimate is 17% higher at Rs11.4 (up 54% YoY) and FY09E EPS up 14% at Rs15.7, up 38% YoY. EPS CAGR FY07-10 is a healthy 46%, even after considering the 8% dilution in equity.

Premium valuation justified; target price Rs314

The stock is trading at a PE of 24x FY08E and 18x FY09E. We believe EKCL will enjoy premium valuation due to high earnings growth, coupled with 25%+ RoE and near zero debt.

We value the stock at 20x FY09E EPS to arrive at a target of Rs314, 13% upside from current levels. We believe there is room for earnings upgrade and valuation re-rating. We maintain **Buy**.

Everest Kanto Cylinders: an investment profile

Company description

Everest Kanto Cylinders is among the world's top 10 players in the high-pressure cylinders business with a current capacity of 800,000 cylinders. It has almost 80% share of the Indian market. It makes three major products: (1) industrial cylinders, (2) CNG cylinders for automotive OEM fitment and replacement, (3) gas cascades, used for storing gas in fuel stations.

Key investment arguments

- ✍ Excellent play on global CNG drive, specially in India and China.
- ✍ Timely expansion plans lined up, both in India and China – capacity to increase from 800,000 to 2.8m cylinders in four years.
- ✍ Robust EPS CAGR of 46% through FY10 and health RoE of over 20% merit premium valuation..

Key investment risks

- ✍ Execution risk, specially in China.
- ✍ Dependence on Tenaris for raw material (seamless tubes), and likely pressure on margins due to rising steel prices.

Recent developments

- ✍ October 2007 – Completed US\$35m issue of FCCBs, convertible into shares at Rs303.36.
- ✍ October 2007 – Raised US\$22.5m (Rs887m) by placing 3.55m shares with private equity investors at Rs250 per share.
- ✍ October 2007 – 2nd unit at Dubai commissioned.

Valuation and view

- ✍ The stock is trading at a PE of 24x FY08E and 18x FY09E. Premium valuation justified given high earnings growth and healthy RoE.
- ✍ We maintain **Buy** with a price target of Rs314 (20x FY09E EPS), 13% upside.

Sector view

- ✍ Global demand for CNG cylinders is expected to remain high due to the 'green drive'.
- ✍ Countries like India and China lag behind much smaller peers like Pakistan and Argentina in terms of number of CNG vehicles. Improving availability of gas should boost cylinder demand, both for OE fitment and for retrofitting existing vehicles.

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	11.4	10.0	13.9
FY09	15.7	13.8	13.6

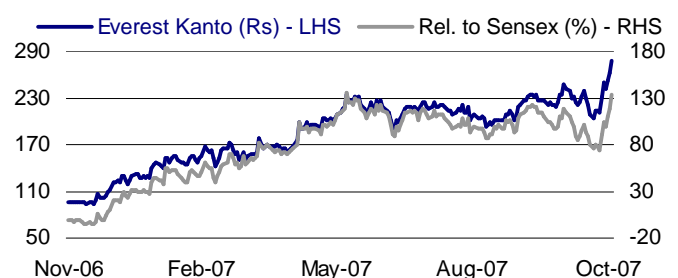
TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
277	314	13.4	Buy

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	61.8	61.8	68.5
Domestic Inst	5.1	4.5	6.9
Foreign	21.5	24.2	12.5
Others	11.7	9.5	12.2

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						RATIOS					
(RS MILLION)											
Y/E MARCH	2006	2007	2008E	2009E	2010E	Y/E MARCH	2006	2007	2008E	2009E	2010E
Net Sales	2,355	4,251	5,858	8,419	12,194	Basic Ratios (Rs)					
Change (%)	78.0	80.5	37.8	43.7	44.8	EPS	3.8	7.4	11.4	15.7	22.8
EBITDA	589	1,145	1,699	2,486	3,651	Growth (%)	59.5	95.5	54.4	38.2	45.1
Change (%)	102.8	94.5	48.4	46.4	46.9	Cash EPS	4.9	9.2	13.7	19.4	28.5
EBITDA Margin (%)	25.0	26.9	29.0	29.5	29.9	Book Value	17.1	31.0	48.0	72.2	91.5
Depreciation	98	178	239	395	609	Dividend per share	0.7	1.0	1.6	2.2	3.0
EBIT	491	967	1,459	2,091	3,042	Payout (incl. Div. Tax.) (%)	21.2	15.9	16.5	16.4	15.4
Interest	38	53	94	108	156	Valuation (x)					
Other income	22	40	50	40	50	P/E		37.7	24.4	17.7	12.2
PBT	476	953	1,416	2,023	2,936	Cash P/E		30.2	20.2	14.3	9.7
Tax	141	236	255	364	528	Price/Book Value		8.9	5.8	3.8	3.0
Tax/PBT (%)	29.6	24.7	18.0	18.0	18.0	EV/Sales		6.0	4.6	3.3	2.2
Adjusted PAT	331	718	1,148	1,659	2,407	EV/EBITDA		23.7	16.8	11.8	7.8
Change (%)	134.4	116.5	60.1	44.4	45.1	Dividend Yield (%)		0.4	0.6	0.8	1.1
PAT margin (%)	14.1	16.9	19.6	19.7	19.7	Profitability Ratios (%)					
						RoE	34.4	31.7	29.1	26.6	27.8
						RoCE	35.0	34.4	29.1	29.2	32.0
						Turnover Ratios					
						Debtors (days of sales)	34	47	45	45	45
						Inventory (days of sales)	66	98	73	76	76
						Creditor (days of total exp.)	52	35	30	30	30
						Asset Turnover (x)	1.2	1.1	0.9	1.0	1.1
						Leverage Ratio					
						Debt/Equity (x)	0.3	0.2	0.3	0.1	0.1
						CASH FLOW STATEMENT					
						(RS MILLION)					
						Y/E MARCH	2006	2007	2008E	2009E	2010E
						PBT before EO items	476	953	1,416	2,023	2,936
						Add : Depreciation	98	178	239	395	609
						Interest	38	53	94	108	156
						Less : Direct Taxes	141	236	255	364	528
						(Inc)/Dec in WC	-122	-1,078	-131	-804	-1,114
						CF from Operations	348	-129	1,363	1,358	2,059
						Extraordinary Items	0	0	12	0	0
						CF from Oper. incl. EO it	348	-129	1,376	1,358	2,059
						(Inc)/Dec in Fixed Assets	-598	-717	-2,426	-1,764	-832
						(Pur)/Sale of Investments	-111	-2	-387	500	-1,578
						CF from Investments	-709	-718	-2,814	-1,264	-2,410
						Inc/(Dec) in Net Worth	832	911	861	1,393	0
						Inc/(Dec) in Debt	-93	307	743	-1,058	929
						Inc/(Dec) in Deferred Tax	-13	-13	0	0	0
						Less : Interest Paid	38	53	94	108	156
						Dividend Paid	70	114	189	272	371
						CF from Fin. Activity	617	1,038	1,320	-45	402
						Inc/(Dec) in Cash	257	191	-118	50	50
						Add: Opening Balance	36	290	471	350	400
						Closing Balance	294	480	353	400	450

E: MOST Estimates



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Everest Kanto Cylinders

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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