

Everest Kanto Cylinders

In the red – downgrade to Sell

Volumes dips 16%: During Q2FY10, Everest Kanto Cylinders (EKC) reported a 35% YoY decline in net sales to Rs 1.5bn, as sales volumes dropped 16.5% to 0.16mn cylinders. Blended realisations per cylinder dipped 25.1% to Rs 8,355. Excluding jumbo cylinders, realisations fell 24.2% due to a higher volume share of industrial cylinders and overall pricing pressure. Dubai saw a steep 60% dip in realisations due to lower capacity utilisation and substitution of sales to Iran to other markets like Pakistan where pricing is much lower.

EBITDA margin nose-dives: EKC's EBITDA margins were sapped by poor volume sales and realisations on weak offtake from USA and Dubai units, along with higher contribution from low-margin industrial cylinders. Raw material cost also increased by 1844bps YoY to 58.9% of sales, due to use of high-cost inventory. Employee costs recorded a sharp rise of 602bps YoY to 13.7% of sales on account of pension provision made in its US subsidiary. The Indian markets saw pricing pressure in both, OEM and retrofitting markets. Weak pricing may be partly due to weak demand; we, however, believe that company is losing pricing power in local markets.

PAT declines - company in the red: Weak operating performance coupled with high depreciation pushed the company in the red with a net loss of Rs 55mn. The company's depreciation charges increased due to expansion at Gandhidham and acquisitions in the US and China. EKC managed to reduce its interest costs QoQ due to softening interest rates as well as a paring of overall debt levels.

Estimates lowered: We have lowered our revenue numbers for FY10 and FY11 by 19.8% and 12.4% respectively, to factor in the expected drop in realisations. Moreover, in line with a weaker margin profile, we have lowered our PAT estimates by 65% and 44.7% respectively. We believe that the company's future growth would be volume-driven; however, it faces a tough task ahead in terms of pricing, both locally and internationally. In the absence of sales in the Iran market, EKC will have to continue selling to low-margin markets to utilise its capacities. Moreover, even if sales to Iran resume, pricing in this market would be at least lower by 30%.

Downgrade to Sell: Currently, the stock trades at 34.5 and 16.6x on FY10E and FY11E earnings respectively. In view of the revised estimates and weakening margin profile, we have lowered our target price to Rs 110 from Rs 200 earlier. We have valued the stock based on a P/E of 12x its FY11E earnings. We downgrade the stock to Sell.

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
153	110	SELL	HIGH

BSE	NSE	BLOOMBERG
532684	EKC	EKCL IN

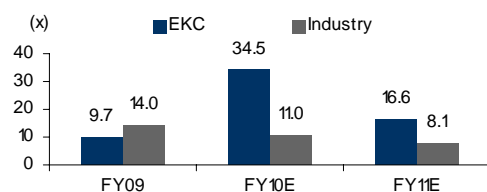
Company data

Market cap (Rs mn / US\$ mn)	15,453 / 326
Outstanding equity shares (mn)	101
Free float (%)	30.6
Dividend yield (%)	1.1
52-week high/low (Rs)	239 / 84
2-month average daily volume	810,543

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
EKC	153	(28.3)	(15.1)	1.0
BSE Cap Gds	13,156	(2.4)	3.9	70.1
Sensex	16,283	(2.5)	6.2	48.0

P/E comparison



Valuation matrix

(x)	FY08	FY09	FY10E	FY11E
P/E @ CMP	14.0	9.7	34.5	16.6
P/E @ Target	10.1	7.0	24.9	12.0
EV/EBITDA @ CMP	13.9	8.0	14.6	10.4

Financial highlights

(Rs mn)	FY08	FY09	FY10E	FY11E
Revenue	5,287	8,562	7,408	9,138
Growth (%)	24.4	61.9	(13.5)	23.4
Adj net income	1,078	1,687	475	984
Growth (%)	50.2	56.5	(71.8)	107.2
FDEPS (Rs)	10.9	15.8	4.4	9.2
Growth (%)	39.7	44.7	(71.8)	107.2

Profitability and return ratios

(%)	FY08	FY09E	FY10E	FY11E
EBITDA margin	28.9	31.0	19.7	22.4
EBIT margin	24.8	22.9	8.4	12.2
Adj PAT margin	20.4	19.7	6.4	10.8
ROE	28.2	31.6	7.6	14.3
ROIC	20.9	19.1	4.4	8.3
ROCE	21.3	19.4	4.9	9.0





Result highlights

Fig 1 - Actual vs. estimated performance

(Rs mn)	Actual	Estimate	% Variance
Net sales	1,449	1,680	(13.7)
EBITDA	162	370	(56.3)
EBITDA margin (%)	11.1	22.0	(1,086bps)
Adj net income	(55)	123	(144.7)
FDEPS (Rs)	(0.5)	1.2	(144.7)

Source: RHH

Results below estimates due to lower volumes and realisations

Fig 2 - Quarterly performance

(Rs mn)	Q2FY10	Q2FY09	% Chg YoY	Q1FY10	% Chg QoQ
Net sales	1,449	2,228	(34.9)	1,530	(5.3)
Expenditure	1,288	1,508	(14.6)	1,198	7.5
EBITDA	162	720	(77.6)	332	(51.4)
EBITDA margin (%)	11.1	32.3	-2117bps	21.7	-1058bps
Other income	19	12	65.2	10	97.9
Interest	30	47	(37.3)	37	(20.9)
Depreciation	198	156	27.1	186	6.5
PBT	(61)	528	(111.6)	214	(128.6)
Tax	(6)	96	(106.3)	48	(112.8)
Adjusted PAT	(55)	432	(112.7)	166	(133.1)
EPS (Rs)	(0.5)	4.3	(112.7)	1.6	(133.1)

Source: Company, RHH

Margins hit by high-cost RM inventory

Net loss of Rs 55m on weak operating performance and higher depreciation

Fig 3 - Revised estimates

Key parameters (Rs mn)	FY10E			FY11E		
	Old	New	% Chg	Old	New	% Chg
Revenue	9,239	7,408	(19.8)	10,431	9,138	(12.4)
EBITDA margin (%)	26.1	19.68	(641bps)	27.1	22.4	(471bps)
Net profit	1,356	475	(65.0)	1,779	984	(44.7)
FDEPS (Rs)	13.4	4.4	(66.9)	17.6	9.2	(47.8)

Source: RHH

Estimates revised to factor in a weak margin profile, going ahead

Fig 4 - Geographic break-up

	Volume (Nos)			Sales (Rs mn)			Realisation (Rs)		
	Q2FY10	Q2FY09	YoY (%)	Q2FY10	Q2FY09	YoY (%)	Q2FY10	Q2FY09	YoY (%)
India	111,024	127,352	(12.8)	702	996	(29.5)	6,325	7,821	(19.1)
Dubai	31,340	51,913	(39.6)	185	771	(76.0)	5,893	14,843	(60.3)
China	22,850	18,372	24.4	278	72	283.5	12,158	3,943	208.3
USA	272	482	(43.6)	218	371	(41.2)	801,103	768,890	4.2
Total	165,486	198,119	(16.5)	1,383	2,210	(37.4)	8,355	11,153	(25.1)

Source: RHH, Company



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY08	FY09	FY10E	FY11E
Revenues	5,287	8,562	7,408	9,138
Growth (%)	24.4	61.9	(13.5)	23.4
EBITDA	1,527	2,658	1,458	2,045
Growth (%)	33.4	74.1	(45.1)	40.3
Depreciation & amortisation	215	693	836	930
EBIT	1,312	1,965	622	1,115
Growth (%)	35.7	49.8	(68.3)	79.3
Interest	71	213	133	129
Other income	31	(100)	83	172
EBT	1,272	1,652	572	1,158
Income taxes	243	154	97	174
Effective tax rate (%)	19.1	9.3	17.0	15.0
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	1,029	1,498	475	984
Adjustments	(49)	(189)	-	-
Adjusted net income	1,078	1,687	475	984
Growth (%)	50.2	56.5	(71.8)	107.2
Shares outstanding (mn)	101.2	101.0	101.0	101.0
FDEPS (Rs) (adj)	10.9	15.8	4.4	9.2
Growth (%)	39.7	44.7	(71.8)	107.2
DPS (Rs)	1.2	1.6	0.5	1.1

Cash flow statement

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Net income + Depreciation	1,244	2,191	1,311	1,914
Non-cash adjustments	34	(1,023)	-	-
Changes in working capital	(1,738)	37	1,108	(445)
Cash flow from operations	(459)	1,206	2,419	1,469
Capital expenditure	(1,620)	(5,420)	(1,087)	(300)
Change in investments	26	98	-	-
Other investing cash flow	(210)	49	-	-
Cash flow from investing	(1,804)	(5,273)	(1,087)	(300)
Issue of equity	887	-	-	-
Issue/repay debt	1,684	3,423	(900)	(142)
Dividends paid	(114)	(142)	(310)	(24)
Other financing cash flow	(59)	(1)	-	-
Change in cash & cash eq	134	(787)	123	1,003
Closing cash & cash eq	622	458	581	1,583

Economic Value Added (EVA) analysis

Y/E March	FY08	FY09E	FY10E	FY11E
WACC (%)	13.6	11.7	11.5	11.8
ROIC (%)	20.9	19.1	4.4	8.3
Invested capital (Rs mn)	6,403	12,222	11,311	11,472
EVA (Rs mn)	467	905	(802)	(405)
EVA spread (%)	7.3	7.4	(7.1)	(3.5)

Balance sheet

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Cash and cash eq	644	458	581	1,583
Accounts receivable	908	980	1,015	1,252
Inventories	2,846	4,887	2,530	2,892
Other current assets	945	876	1,234	1,639
Investments	122	24	24	24
Gross fixed assets	2,413	6,964	9,834	10,334
Net fixed assets	1,544	5,324	7,359	6,929
CWIP	1,113	1,983	200	-
Intangible assets	-	-	-	-
Deferred tax assets, net	(45)	-	-	-
Other assets	-	-	-	-
Total assets	8,076	14,533	12,941	14,318
Accounts payable	774	1,399	825	986
Other current liabilities	155	452	222	274
Provisions	154	390	336	683
Debt funds	2,386	6,220	5,320	5,178
Other liabilities	-	-	-	-
Equity capital	202	202	202	202
Reserves & surplus	4,406	5,870	6,035	6,995
Shareholder's funds	4,608	6,072	6,238	7,198
Total liabilities	8,076	14,533	12,941	14,318
BVPS (Rs)	47.6	62.1	63.8	73.3

Financial ratios

Y/E March	FY08	FY09E	FY10E	FY11E
Profitability & Return ratios (%)				
EBITDA margin	28.9	31.0	19.7	22.4
EBIT margin	24.8	22.9	8.4	12.2
Net profit margin	20.4	19.7	6.4	10.8
ROE	28.2	31.6	7.7	14.7
ROCE	21.3	19.4	4.9	9.1
Working Capital & Liquidity ratios				
Receivables (days)	51	40	49	45
Inventory (days)	268	361	337	206
Payables (days)	72	101	101	69
Current ratio (x)	5.8	3.9	5.1	5.8
Quick ratio (x)	1.7	0.7	1.5	2.3
Turnover & Leverage ratios (x)				
Gross asset turnover	2.4	1.8	0.9	0.9
Total asset turnover	0.8	0.8	0.5	0.7
Interest coverage ratio	18.5	9.2	4.7	8.6
Adjusted debt/equity	0.2	0.6	0.4	0.4
Valuation ratios (x)				
EV/Sales	4.0	2.5	2.9	2.3
EV/EBITDA	13.9	8.0	14.6	10.4
P/E	14.0	9.7	34.5	16.6
P/BV	3.2	2.5	2.4	2.1



Quarterly trend

Particulars	Q2FY09	Q3FY09	Q4FY09	Q1F10	Q2F10
Revenue (Rs mn)	2,228	2,503	1,944	1,530	1,449
YoY growth (%)	74.4	99.4	18.4	(19.1)	(34.9)
QoQ growth (%)	17.8	12.4	(22.3)	(21.3)	(5.3)
EBITDA (Rs mn)	720	716	437	332	162
EBITDA margin (%)	32.3	28.6	22.5	21.7	11.1
Adj net income (Rs mn)	432	382	304	166	(55)
YoY growth (%)	52.1	29.5	(4.6)	(52.5)	(112.7)
QoQ growth (%)	23.5	(11.6)	(20.4)	(45.3)	(133.1)

DuPont analysis

(%)	FY07	FY08	FY09E	FY10E	FY11E
Tax burden (Net income/PBT)	75.3	84.7	102.1	83.0	85.0
Interest burden (PBT/EBIT)	98.6	97.0	84.1	92.0	103.8
EBIT margin (EBIT/Revenues)	22.7	24.8	22.9	8.4	12.2
Asset turnover (Revenues/Avg TA)	117.6	82.6	75.7	53.9	67.0
Leverage (Avg TA/Avg equitiy)	159.4	167.8	211.7	223.2	202.9
Return on equity	31.7	28.2	31.6	7.7	14.7

Company profile

Established in 1978, Everest Kanto Cylinders (EKC) is a pioneer in the development and production of industrial and CNG cylinders with well over 1.5mn high pressure gas cylinders and 500,000 CNG cylinders manufactured since inception. EKC has a dominant 70–75% market share in the domestic high pressure seamless cylinder market and is among the top 10 manufacturers in the world. The company has tie-ups with leading OEMs like Tata Motors, Ashok Leyland and Suzuki, which lends a fillip to sales. Installed capacity stands at 1.03mn cylinders with a capacity of 620,000 units in India, 196,000 in Dubai and 215,000 in China.

Shareholding pattern

(%)	Mar-09	Jun-09	Sep-09
Promoters	59.8	59.8	59.8
FIs	27.2	27.8	29.2
Banks & FIs	3.7	4.1	3.8
Public	9.3	8.3	7.2

Recommendation history

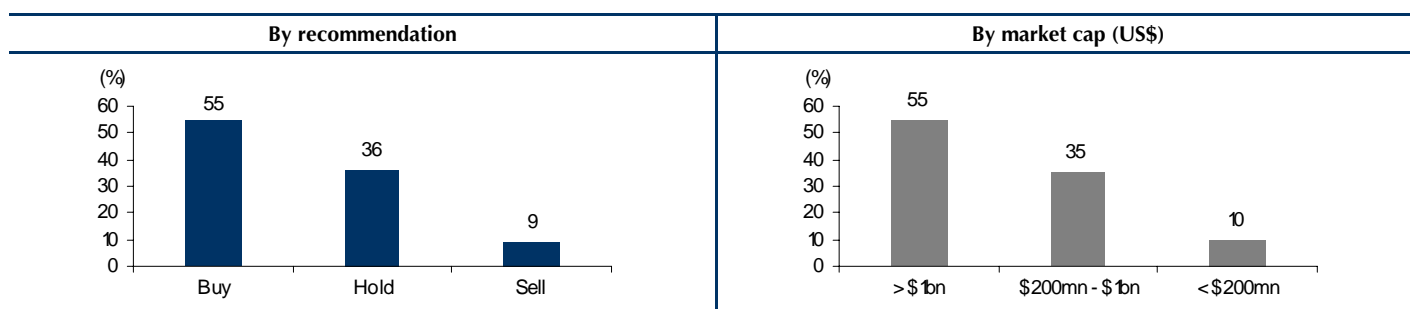
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	318	376	Buy
27-Oct-08	Results Review	160	242	Buy
24-Jan-09	Results Review	137	184	Buy
19-May-09	Results Review	165	160	Hold
16-Jun-09	Mid-caps Picks	224	240	Hold
2-Jul-09	Quarterly Preview	195	240	Hold
29-Jul-09	Results Review	180	188	Hold
02-Sep-09	Religare Conference	187	200	Hold
28-Oct-09	Results Review	153	110	Sell

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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