

Company Flash

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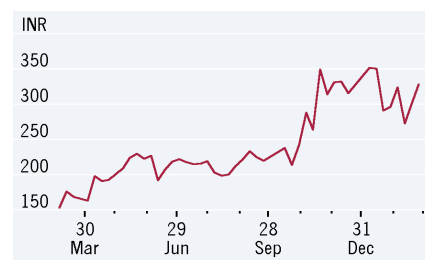
Everest Kanto Cylinder (EKCL.BO)

Buy: Announces Acquisition of US Assets; Appears Positive

- **To buy assets of US company** — EKC has signed an agreement with US-based Reunion Industries to buy the assets of its division, CP Industries (CPI), for US\$64m, subject to various regulatory approvals.
- **World leader in large, seamless cylinders** — Reunion Industries is primarily involved in manufacturing products for the OEM market. It is divesting the assets of CPI, which is under bankruptcy proceedings, with EKC emerging as the highest bidder. CPI is a major global manufacturer of large, seamless, high-pressure cylinders (~2K litre capacity) for storage and transportation of pressurized gases, commanding over c.40% global market share in the segment, and has facilities in Pittsburgh. The cylinders find application in such industries as offshore, transportation, medicine and aerospace, both in the US as well as global markets (exports are c.30% of sales). Key customers include global companies (e.g. Praxair, Air Liquide) US-based firms and the US govt.
- **Profitable business; ~24% operating margin** — CY07 sales of the division were ~US\$41m with EBITDA of ~US\$10m (~24% margins). The facility has a capacity to manufacture ~4K cyl/year, though current utilizations hover around 60-70%, primarily due to the lack of funds and working-capital constraints.
- **Debt-free transaction; prima facie positive** — The transaction would be a pure asset acquisition involving no assumption of debt. The division's strong global presence in the niche, large cylinder segment should complement EKC's dominance in the smaller cylinder segment and appears prima facie positive.

Buy/Medium Risk	1M
Price (04 Mar 08)	Rs288.05
Target price	Rs437.00
Expected share price return	51.7%
Expected dividend yield	0.6%
Expected total return	52.3%
Market Cap	Rs29,138M
	US\$723M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	324	3.68	54.6	78.3	16.8	33.7	0.2
2007A	718	7.35	99.9	39.2	9.3	31.7	0.3
2008E	1,115	10.54	43.4	27.3	6.0	28.4	0.6
2009E	1,748	16.53	56.8	17.4	4.6	31.5	0.9
2010E	2,492	23.56	42.5	12.2	3.5	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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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 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, 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: 1) Exposure to a single supplier – EKC's reliance on Tenaris for most of its raw materials 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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Everest Kanto Cylinder (EKCL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Saurabh Handa (covered since January 5 2007)



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