Friday, December 15, 2010

Initiating Coverage
Sector: Packaging

Everest Kanto Limited	BUY
Horizon	**12 months**
Target Price (Rs.)	**128**
Upside	**35%**

Executive Summary

Everest Kanto Cylinder Limited engages in the development, production, and sale of industrial and compressed natural gas (CNG) cylinders primarily in India. It provides high-pressure gas cylinders for compressed industrial gases. The company also offers allied products, including cylinder valves medical equipment, industrial equipment, it supplies purge bottles/double necked cylinders; medical cylinders; seamless cylinders; and accumulators.

Key Investment considerations

- Capacity Expansion.
- Rise in Crude/ gas price.
- Paradigm shift to CNG vehicles.
- Global Order book to increase.
- Revival in Chinese Operations.

Concerns

- Rise in Metal prices
- Order Delays
- Huge Capex requirement

Investment Strategy

Period	Cash	Derivatives
Short Term	Buy	Iliquid contracts
Mid Term	Start Accumulating	Same as above
Long Term	Start Accumulating	Same as above

Please read our detailed report below for further information, analysis and details of the Greshma CSI Ranking model and the Greshma Risk Return Matrix

Investment Summary:

- **India and Dubai operations fuelling growth:** Indian operation registered robust growth of 26% YoY in revenues with margins of 14.5% against 3.0%. However, there was a one time order of Rs250mn for jumbo cylinders. Sales from Dubai facility doubled YoY to 112k cylinder in H1FY11.
- **Greenfield & Brownfield expansions:** The Company is expanding aggressively its existing capacity at Gandhidham, for manufacture of Jumbo cylinders of capacity of 5000 cylinders per annum and CNG cylinders of 500,000 cylinders, which are expected to yield better realization. EKC has also implemented project in Kandla, with capacity to manufacture 3,00,000 CNG cylinders. Plant at Kandla (where cylinders would be made from billets) is operational also a Greenfield plant in China is being planned to increase EKC's overall capacity to 2.3 million cylinders over the next four-five years.
- **US and China operations expected to contribute this fiscal:** Volumes from both China and US facilities dropped by ~50% YoY resulting in de-growth in top line and negative contribution. However on improving Chinese demand and US economy showing signs of improvement we expect the volumes to normalize this year along with order inflows.
- **Adoption of cost effective technologies expected to boost margins:** EKC has diversified its sourcing of raw material strategy by using alternate manufacturing processes using billets and plates instead of tubes. This would lead to reduced supplier risk. This is likely to reduce its overall expenses leading to a rise in profitability.
- **Ramp up in the sale of jumbo cylinders:** There has been a ramp up in the sale of jumbo cylinders from Gandhidham and China (500 cylinders, realization of ~Rs0.9m/cyl). This will lead to rise in profitability going forward.
- **Growth story intact:** EKC added Maruti Suzuki as its OEM client may drive growth, given the carmaker's wide popularity and distribution reach in the country. Besides, it merits attention that Maruti Suzuki has recently launched the CNG version of its highest selling small car, Alto**.** This will prompt other OEM's (such as Bajaj Auto, Tata Motors, Ashok Leyland, Swaraj Mazda and Hindustan Motors, which are EKC's clients) to push ahead with similar models. Thus the

BUY

CMP (Rs.)	**95.5**
Target price (Rs.)	**128**
Potential upside	**36%**
Holding Period	**12 months**

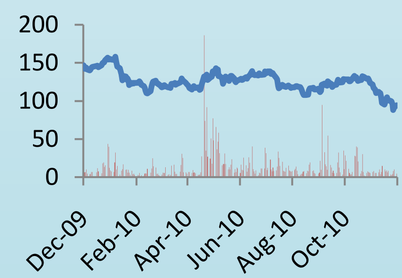
Stock Matrix

No. of shares(mns)	**107.15**
FV(Rs.)	**2.00**
BV	**48.74**
Market Cap(Rs. Mn)	**10,077.46**
52 week high / low(Rs.)	**162.3/83**
Beta	**1.16**
Avg. daily vol. (shares)	**1,71,745**
BSE Code	**532684**
NSE Code	**EKC**

Shareholding (%)

	Jun – 10	**Sep – 10**	**QoQ % Change**
Promoters	56.62	56.83	0.37
FIIs	14.44	11.23	-22.23
DIIs	9.40	9.47	0.74
Individuals	7.75	9.61	24.00
Corporate	3.44	3.79	10.17
Others	8.35	9.07	8.62

Price performance



(Source: Prowess)

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strong economic growth in India accompanied by the focus on reducing pollution would lead to increased demand for the CNG vehicles thereby leading to increased demand for CNG cylinders in future.

- **Rise in Crude Oil Prices and Deregulation in India:** In a scenario where Indian government deregulated the petrol prices around in June, the gap between prices of petrol driven vehicles and CNG driven vehicles has widened since than. Also there was hike in diesel prices and talks over the deregulation of the same. This would drive more demand for CNG driven vehicles thus increasing opportunities making it cheaper source.

Company Background:

Everest Kanto Cylinder Limited engages in the development, production, and sale of industrial and compressed natural gas (CNG) cylinders primarily in India. It provides high-pressure gas cylinders for compressed industrial gases, such as oxygen, hydrogen, nitrogen, argon, helium, and air. The company also offers allied products, including cylinder valves; valve protection guards; valve protection caps; trolleys; medical equipment comprising high-altitude breathing apparatus, oxygen masks, and Boyle's apparatus for anaesthesia; and industrial equipment, which consist of cylinder cascades and quads for the storage and transportation of high-pressure gases. In addition, it supplies purge bottles/double necked cylinders; medical cylinders; seamless cylinders for fire-fighting and beverage applications; and accumulators. Further, the company exports its products to south Asia, South East Asia, and the Middle East, Africa, South America, and CIS countries. Everest Kanto Cylinder Limited was founded in 1978 and is headquartered in Mumbai, India

Key Managerial Personnel:

Key Executives and Professionals	
Name	**Title**
Khurana, Prem Kumar	Founder, Executive Chairman, Managing Director
Khurana, Shyam Sunder	Senior President
Sivakumar, J.	Chief Financial Officer
Khurana, Puneet P.	Whole Time Director
Samvatsar, Pramod M.	Whole Time Director,
Thadani, Chanda Makhija	Compliance Officer and Secretary
Inamdar, Ajit D.	Vice-President of Marketing
Thakkar, Kishore K.	Finance Controller
Croushore, Jack T.	Executive Officer
Jayaprakash, A.	Vice-President of Manufacturing - Dubai
Khamkar, Anil G.	General Manager of Tarapur Works
Khot, V. K.	Vice-President

SWOT Analysis

Strengths:

- Enjoys market leadership in domestic & international markets complying with the high quality standards
- Existing Production Capabilities & Capacities and expansion plans leading to economies of scale which gives edge over competition
- Presence in varied geographies helps in de-risking business model and diversification

Weaknesses:

- Dependence on Government plans & policies for storage and transportation of CNG
- Fluctuation in foreign currency
- Volatile Steel Prices

Opportunities:

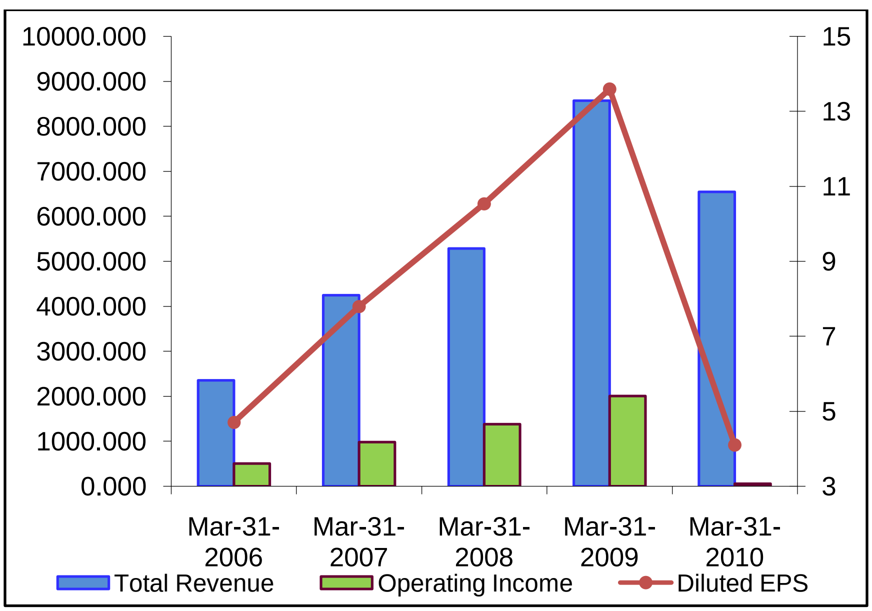
- Economies of scale by full utilization of existing capacities
- Increased and easy availability of natural gas in India would spur the demand for CNG vehicles.
- Rising petrol & diesel prices indirectly boost demand for CNG cylinders
- New gas discoveries by oil majors and auction of next round of NELP blocks

Threats:

- Obsolence in Technology can affect the global operations
- Competition from organized and small unorganized players
- Any Slowdown in the Indian automobile industry would impact majorly

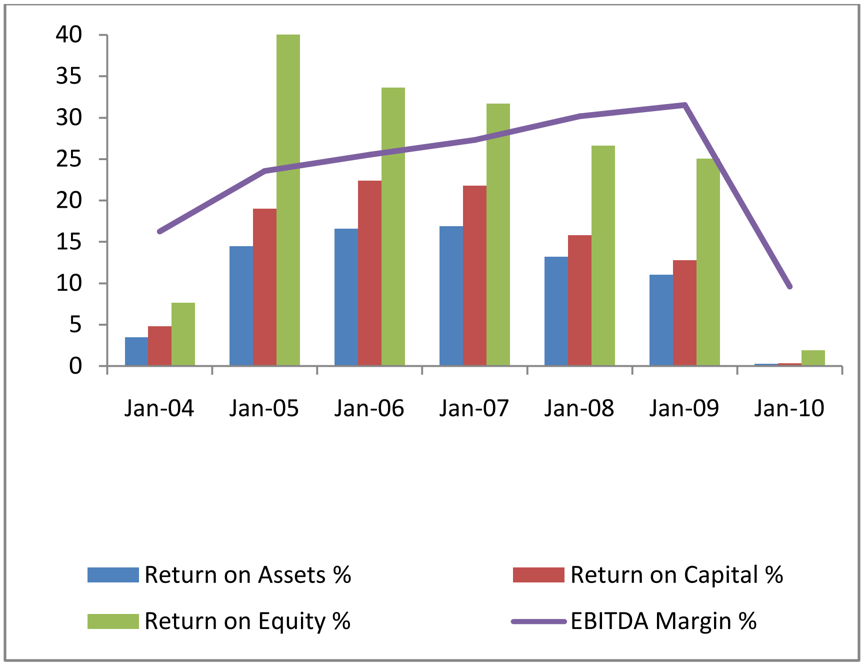
Financials:

	Mar-2009	Mar-2010	Mar - 2011E	Mar-2012E
Total Revenue	**8,571.7**	**6,542.6**	**6055**	**7568.75**
Growth Over Prior Year	*62.1%*	*(23.7%)*	*(7.44%)*	*(25%)*
Gross Profit	**3,752.7**	**1,737.6**	**1513.75**	**1892.18**
Margin %	*43.8%*	*26.6%*	*25%*	*25%*
EBITDA	**2,702.7**	**627.2**	**1114.12**	**1435**
Margin %	*31.5%*	*9.6%*	*18.4%*	*18.4%*
EBIT	**2,010.0**	**58.6**	**908.25**	**1513.75**
Margin %	*23.4%*	*0.9%*	*15%*	*20%*
Earnings from Cont. Ops.	**1,375.3**	**120.8**	**726.6**	**1438.06**
Margin %	*16.0%*	*1.8%*	*12%*	*19%*
Net Income	**1,375.3**	**415.1**	**154.7**	**756.87**
Margin %	*16.0%*	*6.3%*	*25%*	*10%*
Diluted EPS Excl. Extra Items[3]	**13.595**	**1.194**	**1.4**	**6.84**
Growth Over Prior Year	*28.9%*	*(91.2%)*	*17.25%*	*388%*



Operating Income as well as EPS has declined in the year 2010 mainly because of the following:

- Lower orders from Iran.
- Inventory write-offs.
- Global recession leading to a slowdown in consumption of cylinders.



The Company's return on equity has declined from 40% in 2005 to 0.2% in 2010 mainly due to hedging losses and decrease in orders. Going forward we believe the company an increase in consumption of CNG cylinders and debt repayment programs would improve the profitability of the company.

Peer Capacities

Production capacity of various players	
Company	**Capacity**
Faber Industrie S.p.A	850,000
Everest Kanto	1,016,000
Nitin Fire Protection Ind Ltd	500,000
Rama Cylinders	200,000

(Source: Industry)

Valuation

The quarter witnessed some recovery in performance which was due to sale of large Jumbo cylinders which contributed to the top line but this is not likely to repeat in the near future. The company`s new port in Kandla has already started impacting volume growth. The company has shown improvement in volumes and profitability lead by improved sales of high margin cylinders and depletion of high cost Inventory which was a big drag for the company in the last few quarters. Volumes are expected to improve further going forward. EKC is currently trading at EV/Ebitda of 10.79x FY12E Ebitda of Rs 1456mn which is at a discount as compared to its peers. Taking industry average EV/Ebitda of 10.5x we arrive at a target price of Rs 128with a BUY recommendation.

Greshma`s CSI Ranking Model:

Valuations: A

CSI: 4/5

(CSI is arrived on the basis of the underlying strength of the company on the basis of fundamentals and growth prospects)

<table>
<tr><td rowspan="6">Valuation</td><td>> 20%</td><td>A</td><td colspan="2" rowspan="2">HOLD</td><td rowspan="2">BUY</td><td colspan="2">STRONG BUY EKC</td></tr>
<tr><td>+5% TO +20%</td><td>B</td><td colspan="2">BUY</td></tr>
<tr><td>-5% TO +5%</td><td>C</td><td colspan="3">REDUCE</td><td colspan="2" rowspan="2">HOLD</td></tr>
<tr><td>-5% TO -20%</td><td>D</td><td colspan="3" rowspan="2">SELL</td></tr>
<tr><td>< -25%</td><td>E</td><td colspan="2">SELL</td></tr>
<tr><td></td><td></td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td></tr>
<tr><td></td><td></td><td></td><td>VERY POOR</td><td>POOR</td><td>MODERATE</td><td>GOOD</td><td>VERY GOOD</td></tr>
<tr><td></td><td></td><td colspan="6">Core Strength Index</td></tr>
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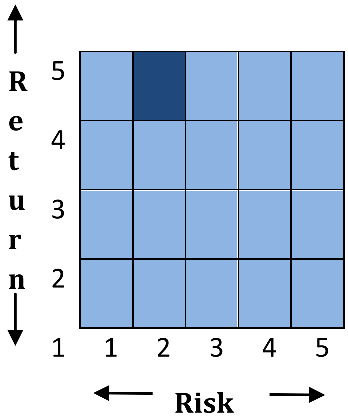
Greshma`s Risk Return Matrix:

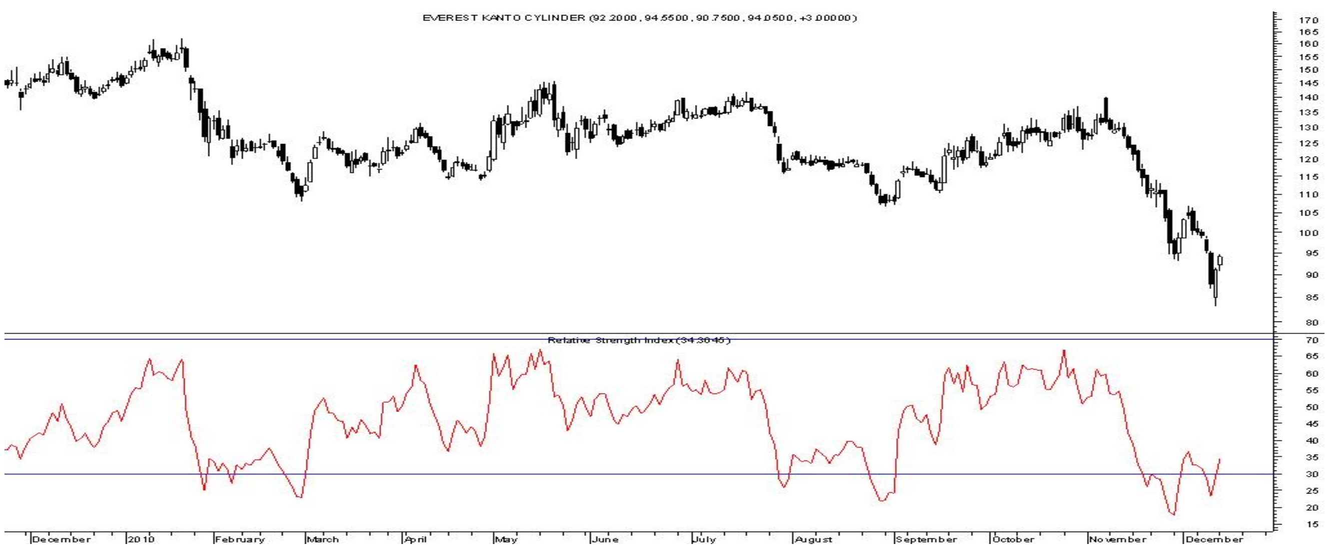
The company is currently positioned as 4/4 on the risk return model which indicates that there is a high possibility of return with risk being high as well.



1 -Low Risk Low Return

5- High Risk High Return

Technical View



- The stock is near the crucial support zone of 85-87 which is to be watched closely in near term.
- Any closing below this level will turn negative and one can expect a downside window to open which can take the stock down to 68-70 levels.
- Being a historical support levels one can expect a short term bounce 102-103 levels.

	Supports	Resistance
1	85-87	105-110
2	68-70	130-135

Expected Stock Performance:

Short Term (1-3 months)	Outperform
Mid Term (6-12 months)	Market Performer
Long Term (more than 12 months)	Out Perform

Investment Strategy:

Period	Cash	Derivatives
Short Term	Buy	Illiquid Contracts
Mid Term	Start Accumulating	Same as above
Long Term	Start Accumulating	Same as above

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