

CRISIL Research revises Everest Kanto Cylinder fundamental grade to 2/5

CRISIL Research has revised Everest Kanto Cylinder Ltd's (Everest Kanto) CRISIL IER fundamental grade to 2/5 (pronounced two on five) from 3/5. The grade indicates that the company's fundamentals are 'moderate' relative to other listed equity securities in India. CRISIL Research has assigned a valuation grade of 5/5, indicating that market price has 'strong upside' from the current level of Rs 26 (as on September 12, 2012). We also revise our one-year fair value to Rs 38 from Rs 53. The grades are not a recommendation to buy, sell or hold the graded instrument, or a comment on the graded instrument's future market price or its suitability for a particular investor.

Continued business underperformance amid sluggish demand, stretched working capital and liquidity issues due to FCCB repayment are the main reasons for the revision in the fundamental grade. Indian operations have been significantly impacted due to lower-than-expected demand for CNG cylinders (because of limited gas availability). We expect CNG supply constraints to continue to hold back demand for CNG cylinders in India in the near term. The Iranian market, which used to consume a significant portion of the sales from Everest Kanto's Dubai operations, has been shut due to sanctions imposed by the US and the European Union. Although the company is exploring other markets including Pakistan, South America, and South Africa, the volumes and realisations in these countries are lower than what it enjoyed in Iran, which affects its operating profitability. Sales volumes of CNG cylinder in Dubai have become one-third after closure of the Iranian market. Weak demand has resulted in underutilised capacity and huge pile up of inventory. The Indian and Chinese operations have reported a lower capacity utilisation of 25% and 16%, respectively, in Q1FY13 leading to low returns. The inventory has increased to approximately one year compared to an average of six to seven months earlier. The company is facing liquidity issues because of US\$35 mn FCCB repayment due in October 2012.

In Q1FY13, its overall revenues declined 12% q-o-q to Rs 1.3 bn following the 31% q-o-q drop in revenues from Indian operations. Adjusted PAT loss was Rs 116 mn compared to a loss of Rs 200 mn in Q4FY12. The return ratios are expected to remain muted in the short to medium term. However, we are positive about the long-term prospects of the CNG market due to the product's inherent advantage. We believe the long-term growth prospects of CNG usage are intact given the advantages of lower running cost and cleaner fuel.

Financial outlook

CRISIL Research lowers earnings estimate due to lower-than-expected demand for CNG cylinders. We lower our revenue estimates by 15% to Rs 6.2 bn for FY13 and by 9% to Rs 7.1 bn for FY14. EPS is expected to be Rs 1.30 in FY14, which is lower than our previous estimate of Rs 3 in FY14. High working capital requirement, weak operating margin and low utilisation levels will keep the return ratio low for the next two years. ROEs are expected to be 1.8% in FY14. We expect FCCB redemption to be refinanced through bank loans/ECB.

Valuation grade (5/5 – current market price has strong upside)

CRISIL Research has used the discounted cash flow method to value Everest Kanto. On account of the downward revision in earnings estimates, we have revised our one-year fair value to Rs 38 per share.

About the company

Everest Kanto manufactures high-pressure seamless CNG and industrial cylinders that are used by automobile OEMs, retrofitters and gas distribution companies. CNG cylinders accounted for 57% of FY12 revenues. It has manufacturing units in India, Dubai, China and the US, with a total capacity of 1.4 mn cylinders per annum.

About CRISIL Independent Equity Research

CRISIL IER (Independent Equity Research) is an independent, unbiased opinion on fundamentals and fair valuation of the company. CRISIL IER encompasses a comprehensive analysis of the four pillars of sustainable value creation, namely: Industry and business prospects, financial performance & outlook, management capabilities and corporate governance.

About CRISIL Fundamental and Valuation (CFV) Matrix

The CFV matrix addresses two important aspects in investment making decision - analysis of fundamentals (addressed through fundamental grade) and analysis of returns (valuation grade). CRISIL's fundamental grade represents an overall assessment of the fundamentals of the company graded in relation to other listed equity securities in India. The grade facilitates easy comparison of fundamentals between companies, irrespective of the size or the industry they operate in. A CRISIL IER fundamental grade of '5/5' indicates 'excellent'

fundamentals and a fundamental grade of '1/5' indicates 'poor' fundamentals relative to other listed equity securities in India. CRISIL's valuation grade represents an assessment of the fair value of the company's stock for an equity investor over a 12-month period. The grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP) to grade 1 (strong downside from the CMP). A CRISIL IER grading should not be construed as a recommendation to invest in the graded security, nor a comment on suitability of a particular investment for the reader.

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About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

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