Everest Kanto Cylinder Limited

February 19, 2020

Ratings

Facilities	**Amount (Rs. crore)**	**Ratings[1]**	**Rating Action**
Long-term fund based bank facilities- Term Loan	37.67 (reduced from 79.99)	**CARE BB+; Stable (Double B Plus; Outlook: Stable)**	**Rating Reaffirmed; (Outlook revised to stable from positive)**
Long-term fund based bank facilities – Cash Credit	91.00	**CARE BB+; Stable (Double B Plus; Outlook: Stable)**	**Rating Reaffirmed; (Outlook revised to stable from positive)**
Short-term non-fund based bank facilities	54.92	**CARE A4+ (A Four Plus)**	**Reaffirmed**
Total Facilities	**183.59 (Rs. One hundred eighty three crore and fifty nine lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Everest Kanto Cylinder (EKCL) continues to derive strength from the promoters experience, established market position of the company in high pressure seamless cylinder industry and diversified customers mix.

The ratings favorably factors in the volume and realization backed growth in its Total Operating Income during FY19. However, owing to moderation in demand from its end user segment primarily the auto segment in India, lower revenue by its CP Industries Inc. USA, change in product mix by EKCL Dubai and higher raw material prices has translated in to lower PBILDT margin during FY19 and 9MFY20 on a consolidated basis. The ratings also favorably factors in improvement in leverage position to 0.65x as on March 31, 2019 as against 0.85x as on March 31, 2018, marked by debt repayment as well accretion to profits. Furthermore, with no major major debt funded capex planned by the company in the medium term up to FY22 coupled with scheduled repayment of term loan the overall gearing is expected to further improve going ahead.

These rating strengths are however, tempered by working capital intensive nature of operations and exposure to volatility in commodity prices/ foreign exchange rates. CARE also takes a note of significant delay remittance of proceeds from sale of its China unit. However, same is in its advance stage of completion.

Outlook: Revised from Positive to Stable

Positive outlook assigned previously factored in the CARE's belief that the financial risk profile would improve on back of remittance of sale proceeds from China within certain timelines. It was previously envisaged that, the remittance may be used for reduction of debt and growth capex. The proceeds from remittance however has been delayed then envisaged timelines.

Rating Sensitivities

Positive Factors

- Improvement in profitability margins over 16% going forward on sustained basis.
- Improvement in ROCE (Return On Capital Employed) over 12% on sustained basis

Negative Factors

- Sustained decline in its RoCE below 9%
- Any large debt funded capex/ acquisition thereby deteriorating the Total Debt / EBITDA over 1.0x on sustained basis.
- Any further, delay in remittance of proceeds from its China unit sale.

[1] *Complete definition of the ratings assigned is available at www.careratings.com and other CARE publications.*

Detailed description of the key rating drivers

Key Rating Weaknesses

Working capital intensive nature of operations: EKCL's operations are inherently working capital intensive in nature due to procurement of its majority of its raw material (Seamless Steel Tubes) requirement from China which takes a lead time of 3-6 months coupled with relatively smaller credit period and maintenance of inventory. As a result of this, average of maximum utilization fund based facility continued to remain high at 96% for the last 12 months ended December 2019.

Volatility of raw material prices and foreign exchange fluctuation risk: Raw material (imported seamless steel tubes) constitutes majority of operating expenses of EKCL. Fluctuations in raw material prices, therefore, tend to impact the Profit Before Interest Leases Depreciation and Taxes (PBILDT) margins. Any adverse change in the exchange rate between the US Dollar and the Indian rupee will have a negative impact on EKCL's results of operations and financial condition as the seamless steel tubes (basic raw material) are fully imported. EKCL does not hedge its foreign currency exposure thus exposing itself to currency risk.

Key Rating Strengths

Experienced Promoters: EKCL was established in the year 1978 by late Mr. P.K. Khurana. The business is presently being managed by his sons, Mr. Pushkar Khurana (Chairman and Executive Director) and Mr. Puneet Khurana (Managing Director), both have been in the business for about 15 years. Mr. Pushkar is responsible for the operations of EKC Dubai and CPI USA and Mr. Puneet is responsible for EKC India and China and marketing in India and South East Asia. Top officials of EKCL have been associated with the company for a long period of time which provides depth and continuity of management.

Established market position in High Pressure Seamless Cylinders and diversified customer mix: EKCL with its presence in to high pressure cylinders over 4 decades has translated EKCL in to one of the largest high pressure cylinder company in India. Further, EKCL has diversified customer mix consisting of OEM (Original Equipment Manufacturers) consisting of Bajaj Auto Limited, Tata Motors Limited, Ashok Leyland etc. The customers also include some of the large industrial gas manufacturers like PraxAir, SML ISUZU, etc. Firefighting companies such as Unite Technologies, Tyco, Siemens, Minimax, etc and Citi gas distribution gas like Adani Gas, Mahanagar Gas, Indraprashta Gas etc. Further, the company has manufacturing facilities in Dubai and USA apart from India. EKCL exports to over 25 countries in South East Asia, Middle East, Africa, US, Europe, South America and CIS countries.

High entry barriers and regulated nature of industry: The existing stringent regulation w.r.t testing and clearance at multiple levels as per the directive of Petroleum and Explosive Safety Organization poses an entry barriers to new entrants to the high pressure seamless cylinder manufacture. Further, the companies also need to take approval of the Chief Controller of Explosives (CCOE) for import in India. Also, the companies operating in this industry are to follow stringent quality standards for manufacturing the cylinders. Thus the industry is exposed to high entry barriers.

EKCL continued to report growth in TOI on a YoY basis during FY19 and 9MFY20: EKCL's Total Operating Income (TOI) on a consolidated basis grew by 29% on a YoY basis to Rs.713.15 crore, primarily led by growth in volumes of both CNG (Compressed Natural Gas) cylinders sold to OEMs (Original Equipment Manufacturers) as well as Industrial cylinders. The growth in TOI was also on account of increase in prices of imported steel tube and pipes which being the key raw material consumed by EKCL translating in to higher realisation. During 9MFY20, the total operating income witnessed a growth of 9% on a YoY basis, led by improved volumes of its Jumbo Cylinders and improved realisation.

Despite strong growth in TOI, EKCL's PBILDT margin continue to decline during FY19 and 9MFY20; Though the company continued to witness a growth in TOI, the PBILDT margin continued to show a declining trend both in FY19 and 9MFY20 on a YoY basis. The lower margin in FY19 was mainly attributable to i) Lower realisation on sale of material at its China subsidiary and ii) decline in EKCL's sales to US Navy by its US subsidiary consequent to Navy's restriction on supply of Cylinder as the authority was reviewing certain quality system and welding procedures, iii) Higher raw material cost. Furthermore, CP industry Holdings Inc. reported a higher EBIT level of Rs.6.13 crore during 9MFY20 as against a loss of Rs.0.83 crore in 9MFY18, consequent restriction imposed by US Navy, thus impacting the EBIDTA margins of EKCL on a consolidated basis as a whole. Further, in line with decrease in PBILDT margin coupled with significant increase in depreciation expense EKCL's PAT margin witnessed a significant decline of 409 bps on a YoY basis in 9MFY20.

Improved leverage; albeit moderation in coverage indicators: EKCL has comfortable financial profile with overall gearing improving on consolidated basis at 0.5x as on March 31, 2019 from 0.85x as on March 31, led by scheduled repayment and accretion of profits to reserves. Going forward the overall gearing is expected to improve given no major debt funded capex planned by the company in the medium term up to FY22. Despite decline in PBILDT margins by 223 bps in FY19, the PBILDT interest coverage improved to 2.80x in FY19 as compared with 2.58x for FY18, which was mainly on account of lower interest expense as a result of repayment of debt. However, led by decrease in PBILDT margin consequent to overall sluggish market scenario for EKCL India especially from the auto segment coupled with lower sales of high margin products by its Dubai subsidiary and continued losses reported by CP Industries, USA, the interest coverage declined to 2.89x during 9MFY20 as against 3.00x in 9MFY19.

Furthermore, GCA (Gross Cash Accruals) declined in absolute terms to Rs.31.63 crore in FY19 as against Rs.55.67 crore consequent to losses of Rs.14.70 crore from discontinued operations of its China unit which is at its advance stages of closure as well as moderation in PBILDT margin in FY19 as compared to FY18. Resulting which despite decline in debt as on March 31, 2019 as compared to March 3, 2018, total debt to GCA (TDGCA) deteriorated to 10.64x as compared to 6.77x respectively. With no debt funded capex plan coupled with scheduled repayment of loan as well as stable operations expected the TDGCA is expected to improve going ahead.

Liquidity position; Stretched

EKCL's owing to its inherent nature of business in which it operates continues to remain working capital intensive, with working capital cycle continue to remain high at over 200 days, resulting which, the working capital utilisation of fund based facility continued to remain high at 96% for the last 12 months ended December 2019 for its EKCL India. Further, the company is projected to generate a GCA of Rs.66 crore during FY20 (P) on a consolidated basis, as against this the company has liability of Rs.48.25 crore to be done during FY20. The company had a moderate cash balance of Rs.8.40 crore as on March 31, 2019 and Rs.6.59 crore as on September 30, 2020.Further, as on February 05, 2019 the company has already repaid the debt obligation to an extent of Rs.46.46 crore out of the total repayment of Rs.48.25 crore during FY20.
EKCL India is expected to receive Rs. 60 crore from sale proceeds of China subsidiary by March 2020 of which ~Rs. 38 crore would be paid to Yes Bank term loan and rest would be used for working capital and capex purposes. Thus liquidity profile is expected improve going ahead.

Analytical approach: Consolidated, while arriving at the rating care has considered consolidated financials as all its subsidiaries are in the similar line of business and are under the same management. Following are the list of companies considered in consolidation along with their holdings by EKCL as on March 31, 2019 is provided below.

Name of the subsidiary	**Country**	**Holding**
EKC International FZE	UAE	100
CP Industries Holdings, Inc.	USA	100
EKC Industries (Tianjin) Co. Ltd.*	China	100
EKC Industries (Thailand) Co. Ltd.	Thailand	100
Calcutta Compressions and Liquifaction Eng. Ltd.	India	72.65
EKC Hungry Kft.	Hungary	100
Next Gen Cylinder Pvt. Limited	India	100
EKC Europe GmbH	Germany	100
EKC Positron Gas Limited	India	72.65
Name of the JV	Country	Holding
Kamal EKC international Limited	Tanzania	49

**During FY19, EKCL along with its UAE subsidiary had entered into an agreement to sell its entire stake in China subsidiary to a company in China , for an aggregate consideration of RMB 93.50 Million (approx. Rs. 96.56 crore). The sale process has commenced wherein EKCL is in advanced stage of consummation of the agreement.*

Applicable Criteria

- Criteria on assigning Outlook and Credit Watch to Credit Ratings
- CARE's Policy on Default Recognition
- Criteria for Short Term Instruments
- Rating Methodology-Manufacturing Companies
- Financial ratios – Non-Financial Sector

About the Company
Incorporated in 1978, EKCL is engaged in the manufacturing of high pressure seamless cylinders for industrial gases and CNG applications, large diameter high pressure seamless vessels, large seamless cylinders, jumbo cylinders and jumbo skids for the storage and bulk transportation of CNG and various other industrial and specialty gases like Nitrogen, Helium, Argon, etc. The products manufactured by EKCL find application in domestic and international markets like aerospace, chemical processing, construction, food production, industrial controls, medicine, nuclear and power propulsion systems, CNG City Gas Projects, etc. The company has two facilities to manufacture cylinders in India (located at Tarapur in Maharashtra and Kandla in Gujarat) as well as Outside India (located at Dubai, China & USA).

Brief Financials (Rs. crore)	**FY18 (A)**	**FY19 (A)**	**9MFY20**
Total operating income	554.37	713.15	568.08
PBILDT	94.05	105.07	78.33
PAT	23.80	58.42*	2.73
Overall gearing (times)	0.85	0.65	--
Interest coverage (times)	2.58	2.80	2.89

A: Audited, Financials are classified as per CARE Standards. * The PAT includes deferred tax assets of Rs. 57.07 crore during FY19.

Status of non-cooperation with previous CRA: CRISIL has reaffirmed EKCL rating at CRISIL C, Issuer Not Cooperating based on best available information vide PR dated December 20, 2019.

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	Oct.2020	37.67	CARE BB+; Stable
Fund-based - LT-Cash Credit	-	-	-	91.00	CARE BB+; Stable
Non-fund-based - ST-BG/LC	-	-	-	54.92	CARE A4+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Term Loan	LT	37.67	CARE BB+; Stable	-	1)CARE BB+; Positive (15-Feb-19)	1)CARE BB; Positive (16-Nov-17)	1)CARE B (06-Oct-16)
2.	Fund-based - LT-Cash Credit	LT	91.00	CARE BB+; Stable	-	1)CARE BB+; Positive (15-Feb-19)	1)CARE BB; Positive (16-Nov-17)	1)CARE B (06-Oct-16)
3.	Non-fund-based - ST-BG/LC	ST	54.92	CARE A4+	-	1)CARE A4+ (15-Feb-19)	1)CARE A4+ (16-Nov-17)	1)CARE A4 (06-Oct-16)
4.	Term Loan-Long Term	LT	-	-	-	1)Withdrawn (15-Feb-19)	1)CARE BB; Positive (16-Nov-17)	1)CARE B (06-Oct-16)

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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