APL Apollo Tubes

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Iron and Steel Products	Rs. 1710	Buy at LTP and add on dips to Rs1515-1532 band	Rs.1880	Rs.2029	2 quarters

HDFC Scrip Code	APLAPO
BSE Code	533758
NSE Code	APLAPOLLO
Bloomberg	APAT
CMP July 16, 2020	1701
Equity Capital (Rscr)	24.9
Face Value (Rs)	10
Equity Share O/S (cr)	2.49
Market Cap (Rscrs)	4280
Book Value (Rs)	528
Avg. 52 Wk Volumes	46457
52 Week High	2216
52 Week Low	1025

Share holding Pattern % (Mar, 2020)	
Promoters	38.4
Institutions	13.7
Non Institutions	47.9
Total	100.0

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Our Take:

APL Apollo Tubes Limited is the largest producer of Electric Resistance Welded (ERW) Steel Pipes and Sections in India, with a capacity to produce 2.5 Million Tonnes per annum. It is the **largest structural steel pipe manufacturing in India.** The company has outperformed industry growth by gaining market share from small and unorganized players. APL Apollo registered sales volume of 400,616 tonnes in Q4 FY20 (lower by 4% YoY) and 1643632 tonnes in FY20 (higher by 21%).

Whilst the nation was fighting against the pandemic and consequent lockdown, APL Apollo registered promising volumes in Q1FY21, where it achieved 61% of its Q1FY20 volume at 238k ton. APL Apollo has the ability to grow at a faster rate than its peers due to its entrenched distribution network and continuous adoption of new technologies.

The acquisition of Apollo Tricoat (in Oct 2018) has helped APL Apollo to expand its portfolio in high margin segment. APL Apollo being in a competitive industry has managed well to maintain its leadership. APL Apollo have also been ahead of the curve in adopting new technology to enhance business and efficiency, APL Apollo was pioneer to bring Direct Forming Technology (DFT) which has helped company to reduce its overall manufacturing time. DFT technology can produce a custom size in 45 minutes vs. 8-9 hours required by erstwhile technology.

Valuations &Recommendation:

APL Apollo capacities have doubled over the last two years through a series of organic and inorganic expansions. The company over the past five years has compounded revenue at ~23% and profits at ~20%. Management has guided no further capex in the immediate future or until existing capacities achieve optimal utilization. Management has guided a 20% CAGR sales volume growth over the next few years, given the demand from Infrastructure, Construction, Automobiles, Energy and Agriculture sectors. However, in the near future volumes would be impacted due to the pandemic.

Going forward, the company has a vision to touch Rs. 5000 EBITDA/ton (from FY20 Rs.3058/ton) which will improve margins. Over the next two years, we estimate Revenues/EBITDA/PAT to grow at CAGR of ~8%/13%/13% on the back of strong volume growth, cost efficient measures by the company through adoptions of new technology and ramp up of operations in Apollo Tricoat. The stock is trading at valuations of ~14x FY22E earnings. We think the Base case fair value of the stock is Rs1880 (15.75xFY22E EPS) and the bull case fair value of the stock is Rs2029 (17.0xFY22E EPS) over the next 2 quarters. Investors can buy the stock at the CMP and add on dips to Rs.1515-1532 band (12.75XFY22E EPS).

Financial Summary

Particulars (Rs cr)	Q4FY20	Q4FY19	YoY-%	Q3FY20	QoQ-%	FY19	FY20	FY21E	FY22E
Net Revenues	1889	2094	-10	2116	-11	7152	7723	7028	8152
EBITDA	120	138	-13	161	-25	393	478	351	542
Depreciation	25	17	47	26	-4	64	96	109	113
Other Income	8	3	167	5	60	12	22	15	15
Interest Cost	24	29	-17	28	-14	113	108	72	48
Tax	18	34	-47	28	-36	79	40	47	99
APAT	61	61	0	84	-27	147	255	137	296
Diluted EPS (Rs)	23	26		30		62.2	102.9	56.6	119.3

(Source: Company, HDFC sec)

Recent Developments

- In Q4FY20, consolidated revenue from operations declined 10% YoY to Rs. 1889 crore while EBITDA declined 14% YoY to Rs. 120 crore. EBITDA margins stood at 6.3% compared to 6.6%. Net profit came in at Rs. 57 crore, 8% decline YoY.

- EBITDA/Ton declined 5% YoY to Rs. 3200 due to volume loss in March owing to COVID-19 impact. Depreciation costs increased 48% YoY due to capacity expansion while interest cost declined 17% YoY on the back debt reduction. Sales volume for Q4FY20 declined by 4% YoY to 401k ton.

- Company net working capital days improved to 20 days in FY20 from 28 days in FY19. As on March, 2020 debt-equity stands at 0.6x. In FY20, APL Apollo market share in structural steel tube sector increased to 40% from 36%, company is targeting higher market share in FY21 on the back of aggressive sales strategies and advanced technology.

- Whilst the nation was fighting the COVID-19 pandemic and consequent lockdown, APL Apollo registered promising volumes figures in Q1FY21. The total sales volume for Q1FY21 stood at 238k ton (61% of Q1FY20 volume and 59% of Q4FY20 volume). Production was completely stopped post March 23 and resumed from April 24. While sales in metros have taken a back seat, Tier 2&3 cities are showing strong traction and now account for 75% of revenues (40% last year). Fall in Apollo Tricoat's volumes was lower than the overall volumes as roofing segment sales did well in Q1 – a seasonally strong quarter.

- Recently the industry has made a shift to cash sales only which is resulting in sharp drop in receivables which will also enable the company to grow aggressively with lower working capital requirements. APL APollo also reduced debt by Rs410 cr, reducing D/E to 0.3x from 0.6x in Q4FY20. This deleveraging was due to efforts to reduce debtors which decreased to 9 days from 23 days at FY20-end.
- Acquisition of Apollo Tricoat In Oct 2018 which is the first company to introduce 'Galvant Technology' will enable company to expand its portfolio in the high margin segment. Tricoat has a production capacity of ~2,50,000 MTPA which includes

~50,000 MTPA of In-line Galvanised pipes (ILG), 100,000 MTPA of designer pipes, ~50,000 MTPA of Door Frames and balance 50,000 MTPA of narrow sections. Per ton EBITDA on ILG and designer pipes is ~Rs 6000-7000, while that on door frames and narrow sections is lower at ~Rs 4000-5000. Apollo Tricoat has 11% odd operating margins vs 5-6% of APL Apollo. APL Apollo bought shares of Apollo Tricoat @Rs.168.50 in Oct 2018 vs CMP 410.

- The company expects EBITDA/tonne to improve further due to better product mix and volume growth. Going forward, company vision is to achieve EBIDTA/tonne of around Rs. 5000. FY20 EBITDA/tonne came at Rs. 3058.

- APL Apollo capacities have doubled over the last two years through aseries of organic and inorganic expansions. The company over the past three years has compounded revenue at ~23% and profits at ~20%. Management has guided no further capex in the immediate future or until existing capacities achieve optimal utilisation. Management aims at 20% CAGR sales volume growth over the next few years, given the demand from Infrastructure, Construction, Automobiles, Energy and Agriculture sectors. However, in the near term future volumes would get impacted due to the pandemic.

Long term Triggers

- APL Apollo Tubes is the largest producer of Electric Resistance Welded (ERW) Steel pipes and Sections in India, with a capacity to produce 2.5 Million Tonnes Per Annum. ERW steel pipes market is expected to grow at ~10%-12% CAGR providing a huge opportunity for the company. They are used for various purposes like transporting water, oil and other liquids and gases. With the development of technology they are also used in industries like building materials, automobiles and daily utility items. Structural steel pipes is a good alternative structural to conventional materials such as cement, RCC, aluminium and wood which are costlier.

- Currently, company has the largest and most entrenched distribution networks in the structural steel sector in India with pan India presence and strong dealer distributor network of roughly 800+ distributors, 27 warehouses and 50,000+ retailers.

- APL Apollo has increased its capacity three times in last couple of years but was unable to increase utilization rates at the same pace resulting in lower fixed cost absorption. However, now the company has sufficient capacity to grow for next 2 years and at full capacity utilization, its margins could expand smartly.

- Company on a continuous basis endeavors to bring in new technologies for the betterment of the business and its processes. It was the first company to offer pre-galvanized and colour coated pipes and then in 2016 company was pioneer to bring Direct Forming Technology (DFT) which allows it to offer customized products at lower cost with shorter lead times as unlike technology, where round pipes were formed first and then converted to square or rectangular, DFT enables direct formation of hollow pipes of various sizes and shapes. DFT enhances the efficiency and reduces material cost by 2-10%. Further, DFT can process smaller orders in 30-40 minutes compared to traditional methods which would take 6-8 hours.

- APL Apollo being the leader in the industry enjoys easy raw material sourcing and at favorable price compared to peers. With steel being the major raw material for the company, company buys 2% of Indian Steel consumption and 10% of Indian HR coil consumption. Further, company is amongst top 3 customers for large steel producers. Due to above mentioned facts, company's steel buying price is minimum in structural steel tubing industry.

- The pipe industry -both plastic and steel- is very competitive in nature and thus advertisement and branding plays a key role in the industry. In plastic pipe industry, leaders have adopted aggressive branding which in turn have helped companies to grow its business. APL Apollo has also undertaken advertisement campaign and has engaged Bollywood celebrity 'Amitabh Bachchan' as its brand ambassador. The company has also been sponsoring various sporting events to raise awareness about their brand.

- On the exports side, the company currently caters to over 20 countries globally. There is a strong untapped potential across export markets, especially across USA, Europe and Middle East. With the introduction of latest technologies (such as DFT) and newer product launches (such as Tricoat tubes, narrow sections), the Company will be able to unlock vast potential across markets. High quality, customized and tailor-made shapes and sizes of products, achieved through DFT, will also help cater to the extensive latent demand in the export markets.

- We believe that due to COVID-19 outbreak, many peers of APL Apollo will face significant headwinds to weather this crisis. Due to presence highly overleveraged players with higher working capital days, industry will get further consolidated. We believe APL Apollo being the market leader will able to increase its market share further in FY21 on the back of (1) aggressive sales strategy to hurt weak competitors, (2) strong financials and liquidity position, (3) cost optimization measures and (4) adoption of advance technology.

What could go wrong?

- The unprecedented event of COVID-19 has affected the company's operations and is likely to impact the overall volume growth in near term If the Covid-19 disruption lasts longer than anticipated, the growth of the company will get further disrupted and may lead to stock de-rating.

- Volatility in steel prices as it is a key material for the company. However currently steel prices continue to be soft.

- Overall economic slowdown affecting infrastructure spending.

- Delay in ramp up of operations of Apollo Tricoat could affect the margins of the company.

- Promoters got some bad reviews on the mode of acquisition of Apollo Tricoat. Originally, in Jan'18, Apollo Tricoat was acquired by the promoter family in their personal capacity from the promoter's business associate Saket Agarwal. The board later realized the conflict of interest given that Apoolo Tricoat was in an identical business. This situation was corrected by the promoters by APL Apollo buying the promoter family's stake at the same valuation they invested and promoters infusing capital in APL Apollo at higher valuations to significantly fund the acquisition.

Company Profile:

APL Apollo Tubes Limited is the largest producer of Electric Resistance Welded (ERW) Steel Pipes and Sections in India, with a capacity to produce 2.5 Million Tonnes per annum. It caters extensively to the region and exports to over 20 countries globally. The company's vast distribution network is spread across India, with warehouses and branch offices in 29 cities. Currently, APL Apollo has the largest and most entrenched distribution networks in the structural steel sector in India. The company has 800+ Distributors and 50,000+ Retailers.

APL Apollo believes in pioneering changes to cater to an ever-evolving economy by infusing superior cutting-edge Technology and Innovation. APL Apollo serves as a "one stop shop" for a wide spectrum of steel products, catering to an array of industry applications such as urban infrastructure, housing, irrigation, solar plants, greenhouses and engineering.

In October 2018, Shri Lakshmi Metal Udyog Limited (SLMUL), wholly owned subsidiary of APL, announced the acquisition of 8.0 mn shares and subscribed to 4.3 mn warrants of Apollo Tricoat Tubes. The 4.3 mn warrants were converted into equity shares during Q1FY20 bringing SLMUL's stake in APL Tricoat to 50.6%. The acquisition was partly funded after the promoter of APL infused Rs97cr by way of 0.4 mn shares (preferential issue) at a price of Rs1,800 per share. Also, APL has issued 0.5 mn warrants to promoters at a price of Rs. 2,000 per share.

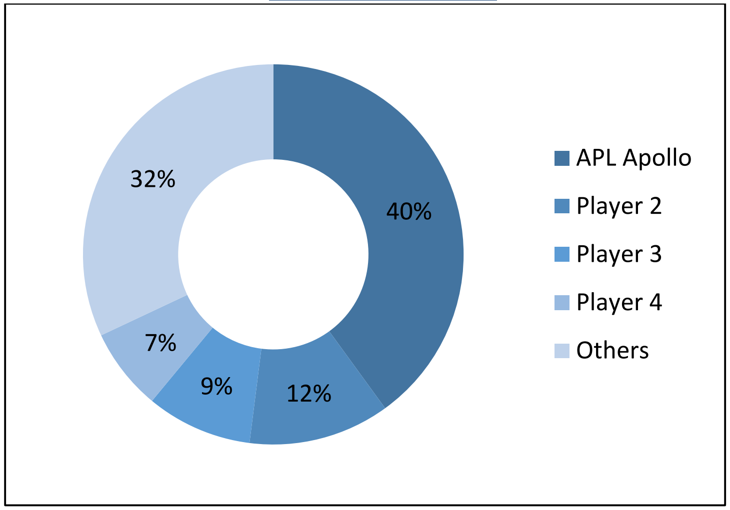
Peer Comparison

Companies	FY20 (Cons.)							
	Capacity (mn MTPA)	Sales	EPS	OPM(%)	PAT (%)	*CMP (Rs.)	P/E	ROCE (%)
APL Apollo	2.5	7723	103	6.2	3.3	1701	16.5	16.2
Surya Roshni	0.9	5471	19	6	1.8	115	6.1	12.8
Hi-tech Pipes	0.6	1210	19	5	1.6	108	5.7	18.3

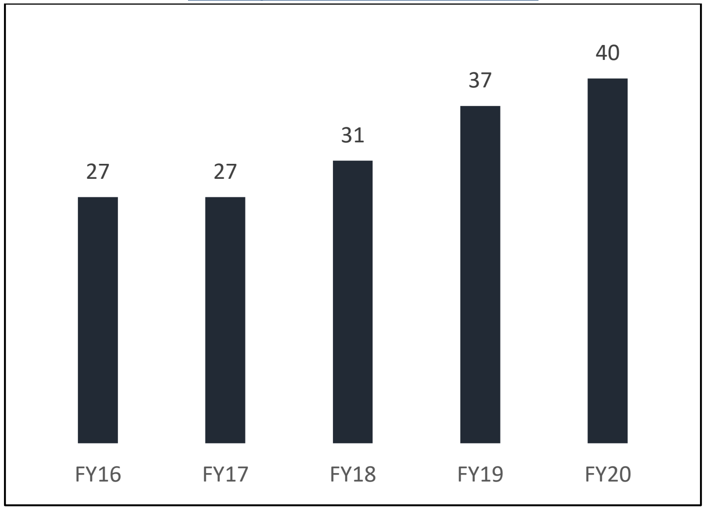
**As on 16 July 2020*

(Source: Company, HDFC sec Research)

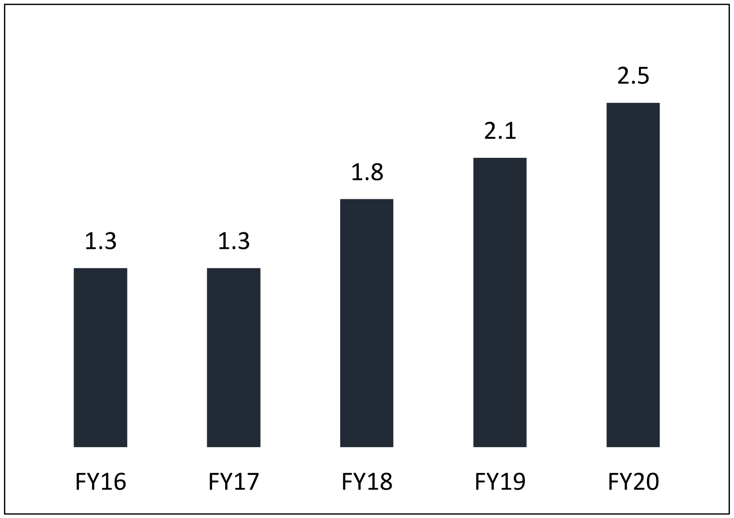
Peer Market Share



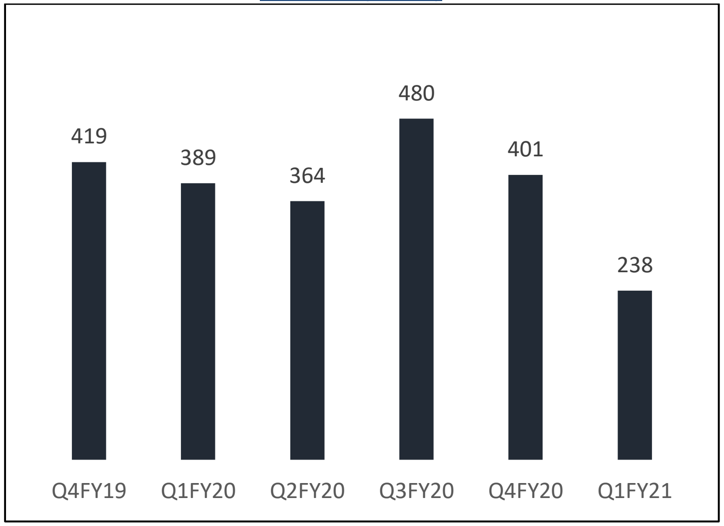
APL Apollo Market Share (%)



Capacity (Mn Tons)



Volume (k ton)



(Source: Company, HDFC sec Research)

Financials

Income Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E
Net Revenue	**7152**	**7723**	**7028**	**8152**
Growth (%)	34.1	8.0	-9.0	16.0
Operating Expenses	6759	7245	6677	7611
EBITDA	**393**	**478**	**351**	**542**
Growth (%)	5.9	21.7	-26.6	54.5
EBITDA Margin (%)	**5.5**	**6.2**	**5.0**	**6.6**
Depreciation	64	96	109	113
EBIT	**329**	**382**	**242**	**429**
Interest expenses	113	108	72	48
Other Income	12	22	15	15
PBT	**226**	**295**	**184**	**395**
Tax	79	40	47	99
RPAT	**147**	**255**	**137**	**296**
Growth (%)	-6.2	72.7	-45.0	110.8
EPS	62.2	102.9	56.6	119.3

Balance Sheet

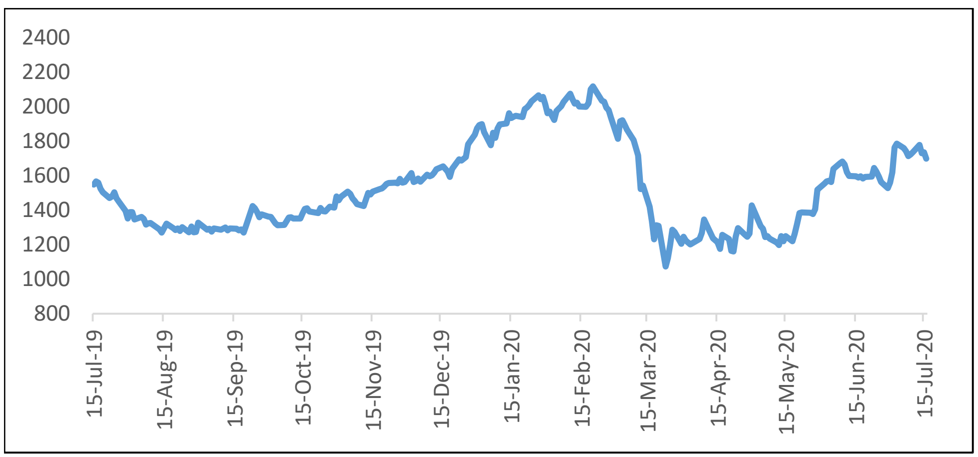
As at March	FY19	FY20	FY21E	FY22E
SOURCE OF FUNDS				
Share Capital	23.9	24.9	24.9	24.9
Reserves	940	1331	1437	1703
Shareholders' Funds	**965**	**1356**	**1462**	**1727**
Long Term Debt	175	404	271	108
Short Term Debt	536	323	274	241
Net Deferred Taxes	120	101	101	101
Long Term Provisions & Others	58	84	60	68
Minority Interest	0	95	95	95
Total Source of Funds	**1853**	**2364**	**2264**	**2341**
APPLICATION OF FUNDS				
Net Block (incl CWIP)	1035	1481	1452	1419
Intangible Assets	3	3	3	2
Goodwill	23	138	138	138
Investments	49	2	2	2
Long Term Loans & Advances	174	193	193	193
Total Non Current Assets	**1285**	**1816**	**1787**	**1754**
Inventories	784	784	674	737
Trade Receivables	543	476	231	290
Short term Loans & Advances	1	1	1	2
Cash & Equivalents	48	46	215	239
Other Current Assets	113	143	149	156
Total Current Assets	**1489**	**1450**	**1271**	**1424**
Trade Payables	699	764	670	723
Other Financial Liabilities	183	114	101	89
Other Current Liab & Provisions	38	22	22	23
Short-Term Provisions	1	1	1	1
Total Current Liabilities	**921**	**902**	**794**	**836**
Net Current Assets	568	548	477	588
Total Application of Funds	**1853**	**2364**	**2264**	**2341**

(Source: Company, HDFC sec Research)

Cash Flow Statement (Consolidated):

(Rs Cr)	FY19	FY20	FY21E	FY22E
Reported PBT	227	296	188	396
Non-operating & EO items	-10	-8	-15	-15
Interest Expenses	113	108	72	48
Depreciation	64	96	109	113
Working Capital Change	26	102	140	-120
Tax Paid	-67	-82	-47	-99
OPERATING CASH FLOW (a)	**353**	**512**	**447**	**323**
Capex	-237	-296	-105	-80
Free Cash Flow	118	214	342	243
Investments	0	-143	50	15
Non-operating income	-27	4	15	15
INVESTING CASH FLOW (b)	**-264**	**-435**	**-40**	**-50**
Debt Issuance / (Repaid)	83	-95	-181	-181
Interest Expenses	-101	-119	-72	-48
FCFE	100	1	89	14
Share Capital Issuance	6	177	0	0
Dividend	-40	-41	-35	-35
FINANCING CASH FLOW (c)	**-53**	**-77**	**-288**	**-264**
NET CASH FLOW (a+b+c)	**37**	**0**	**119**	**9**

One Year Price Chart



Key Ratios (Consolidated):

	FY19	FY20	FY21E	FY22E
EBITDA Margin	5.5	6.2	5	6.6
EBIT Margin	4.6	4.9	3.4	5.3
APAT Margin	2.1	3.3	2	3.6
RoE	16.4	22.1	10	18.6
RoCE	17.7	16.2	10.7	18.3
Solvency Ratio				
Net Debt/EBITDA (x)	1.7	1.4	0.9	0.2
D/E	0.7	0.5	0.4	0.2
Net D/E	0.7	0.5	0.2	0.1
PER SHARE DATA				
EPS	62.2	102.9	56.6	119.3
CEPS	89.1	141.5	100.4	164.8
BV	404	545	588	695
Dividend	14	14	14	14
Turnover Ratios (days)				
Debtor days	28	23	12	13
Inventory days	35	37	35	33
Creditors days	38	39	37	35
VALUATION				
P/E	26.1	15.7	28.6	13.6
P/BV	4	3	2.8	2.3
EV/EBITDA	12.4	10.2	12.9	8.4

(Source: Company, HDFC sec Research)

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Disclosure:

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Any holding in stock –Yes

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