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APL Apollo Tubes Limited

Tricoat merger a step in the right direction

Building Material	Sharekhan code: APLAPOLLO	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,093**	
Price Target: **Rs. 1,330**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

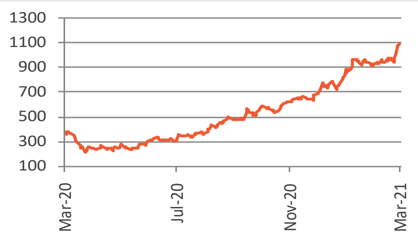
Company details

Market cap:	Rs. 13,633 cr
52-week high/low:	Rs. 1,125/205
NSE volume: (No of shares)	2.2 lakh
BSE code:	533758
NSE code:	APLAPOLLO
Free float: (No of shares)	7.6 cr

Shareholding (%)

Promoters	39.5
FII	17.8
DII	11.8
Others	30.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17	55	130	201
Relative to Sensex	17	44	102	171

Sharekhan Research, Bloomberg

Summary

- APL Apollo Tubes Limited (APL) announced the merger of Apollo Tricoat with itself, wherein minority shareholders of Apollo Tricoat will receive one equity share of APL for one share of Apollo Tricoat. The deal is expected to be completed by December 2021 post regulatory approvals.
- Management has guided that the merger would be EPS/RoE accretive, as equity dilution of 10.8% would get offset by nil minority interest as Apollo Tricoat will get fully merged with APL. The deal values Apollo Tricoat at 16% premium to CMP on February 26, 2021.
- Management expects synergies across cost, products, and branding and expects minimum improvement of Rs. 150/tonne in EBITDA margin although the exact quantum of synergies is to be provided latter. The merger would also facilitate faster capacity expansion and facilitate penetration of Tricoat products in West and East.
- Improved earnings quality post the merger (higher margin/RoE), focus on home décor, and brand building are likely to further re-rate APL and reduce valuation gap with building material players. We retain Buy on APL with a revised PT of Rs. 1,330.

APL Apollo Tubes Limited (APL) has announced the merger of Shri Lakshmi Metal Udyog Limited and Apollo Tricoat Tubes Limited (Apollo Tricoat) with APL through a plain vanilla deal, wherein minority shareholders of Apollo Tricoat will receive one equity share of APL for one equity share of Apollo Tricoat. The deal values Apollo Tricoat at 16% premium to closing price of Rs. 924/share on February 26, 2021 and is expected to be EPS/RoE accretive for APL from the first year of merger as equity dilution of 10.8% would get offset by nil minority interest, as Apollo Tricoat will get fully merged with APL. We believe the merger is a step in the right direction, as Apollo Tricoat has higher EBITDA margin and superior RoE (40%) profile. APL would become the fifth largest structural steel tube company globally with capacity of 2.6mtpa. Management is optimistic of synergy benefits (minimum margin accretion expected at Rs. 150/tonne) across costs (lower distribution cost and plant consolidation), products offerings (benefit of cross selling of products such as Tricoat products in the western and eastern regions), and brand equity. Moreover, management expects the merger to drive fast capacity expansion and better utilisation level, which would help drive sustainable high double-digit volume growth for APL going forward. Given rising application of structured steel tubes and innovative product launches, we believe APL could surprise on earnings growth outlook (we expect a 37% PAT CAGR over FY2021E-FY2023E). Improved quality of earnings post the merger (potentially high margin/RoE), focus to penetrate in the home décor category, and brand building could further re-rate APL and reduce valuation gap with listed building material companies (APL trades at 21.4x its FY2023E EPS versus PE multiple of 30x-63x for companies such as Supreme Industries and Astral Poly Technik). Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,330 [valued at 26x its FY2023E EPS; revision in price target (PT) reflects higher PE multiple].

Our Call

Valuation – Maintain Buy on APL with a revised PT of Rs. 1,330: We maintain our FY2021-FY2023 earnings estimates as we wait exact details on merger synergies from management and regulatory approvals are also pending. We believe the merger is the right step to simplify the corporate structure and would improve margin/RoE profile (Tricoat RoE of 40%). Improved quality of earnings, focus to penetrate the home décor category, and brand building could further re-rate APL. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,330 (valued at 26x FY2023E EPS; revision in PT reflects higher PE multiple). At the CMP, the stock is trading at 27.5x its FY2023E EPS and 21.4x its FY2023E EPS.

Key Risks

Delayed recovery in demand from construction and infrastructure projects and substantial rise in steel price could hurt earnings outlook. Any rise in competition from well-established steel companies could impact volume growth and affect working capital cycle.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	7,152	7,723	8,477	10,276	12,312
OPM (%)	5.5	6.2	7.7	8.6	8.9
Adjusted PAT	148	256	337	494	636
% YoY growth	-6.3	72.7	31.8	46.3	28.9
Adjusted EPS (Rs.)	12.4	20.6	27.1	39.7	51.2
P/E (x)	87.9	53.1	40.3	27.5	21.4
P/B (x)	14.1	10.0	8.3	6.7	5.3
EV/EBITDA (x)	36.3	29.9	20.7	14.9	11.5
RoNW (%)	16.5	22.1	22.6	26.9	27.7
RoCE (%)	19.5	19.3	23.6	28.9	31.4

Source: Company; Sharekhan estimates

Event - Board approved amalgamation of Shri Lakshmi Metal Udyog and Apollo Tricoat into APL

The board of directors of APL has approved draft scheme of amalgamation of Shri Lakshmi Metal Udyog Limited and Apollo Tricoat Tubes with APL Apollo Tubes. As per the deal transaction, minority shareholders of Apollo Tricoat will get equity share of APL Apollo Tubes in the ratio of 1:1 (16% premium to closing price of Rs. 924/share of Apollo Tricoat on February 26, 2021), and there would be dilution of 10.8% in equity share of APL. Appointed date for the merger is set at April 1, 2021, and the merger is expected to be closed in Q3FY2022.

Plain vanilla deal – Swap ratio of 1:1 (One equity share of APL for one equity share of Apollo Tricoat)

Particulars	Deal details
Swap ratio	One equity share of APL for one equity share of Apollo Tricoat
Equity dilution for APL	10.8%
Premium for Apollo Tricoat	16% from closing price of Rs. 924 on February 26, 2021
Capacity of merged entity	2.6mn tonne (fifth largest structured steel company globally)
Regulatory approvals	SEBI, BSE, NSE, and NCL approval required (all approved expected by Q3FY2021)
Appointed date for merger	April 1, 2021

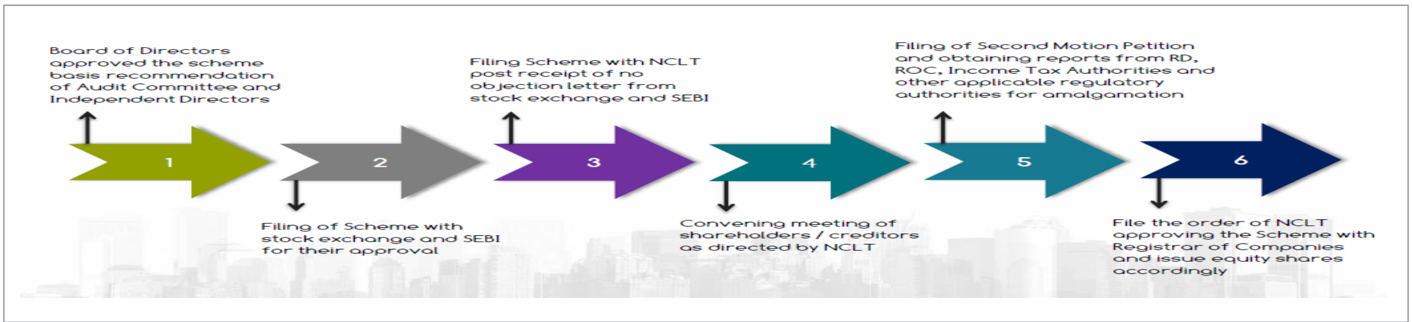
Source: Company

Deal to be EPS and RoE accretive

Particulars	APL Apollo Tubes (Consolidated)	APL Apollo Tubes (Merged + Consolidated)	Accretion
Net profit (Rs. crore)	240	272	13.5%
RoE (%)	22.1	25.5	340bps
EPS (Rs.)	19.2	19.7	2.6%
Asset base (Rs. crore)	3,065	3,196	4.3%

Source: Company

Deal expected to be completed by December 2021

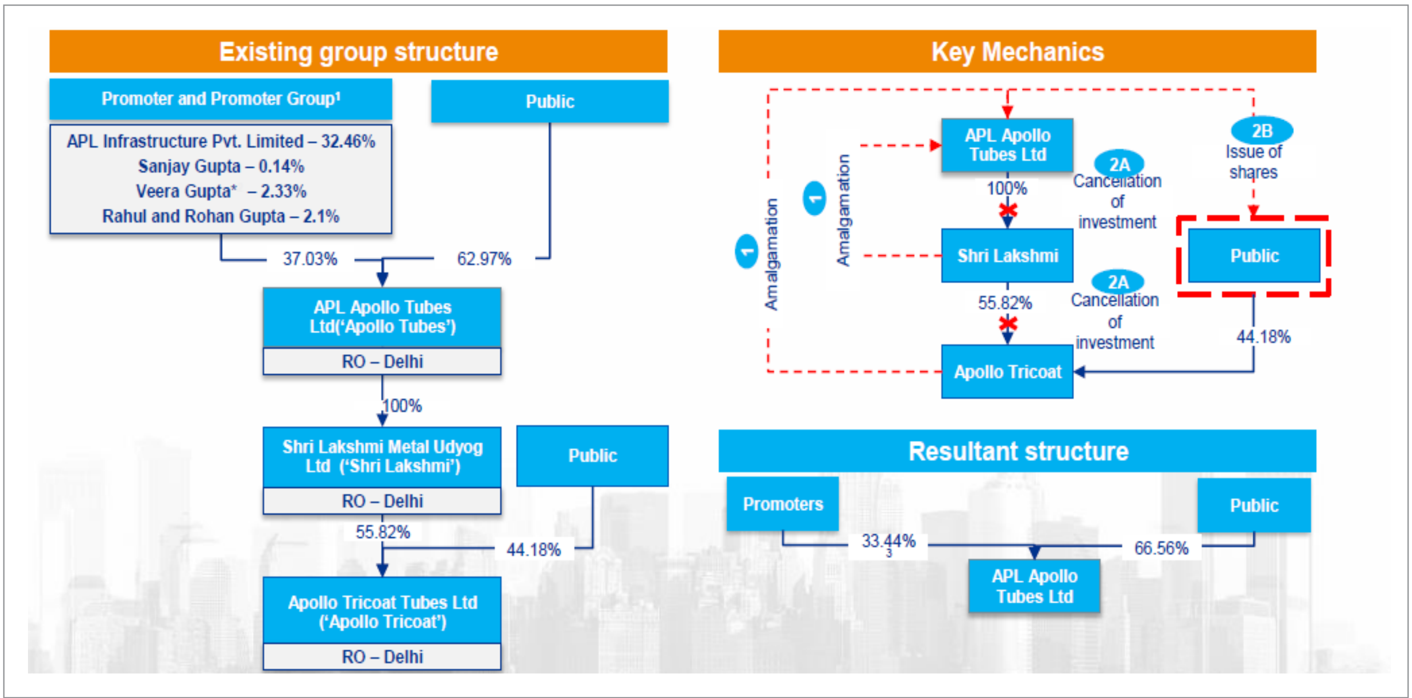


Source: Company

Merger rationales

Source: Company

Merger arrangements between APL and Apollo Tricoat



Source: Company

Post Amalgamation P&L Statement for 9MFY2021 Rs crore

Particulars	APL Apollo Tubes (Consolidated)	APL Apollo Tubes (Merged + Consolidated)	Accretion/dilution
Revenue from operations	5,913	5,913	0.0%
EBITDA	472	472	0.0%
Profit before tax	369	369	0.0%
Tax	95	95	0.0%
PAT	273	273	0.0%
MI	32	0	-100.0%
PAT after MI	240	272	13.4%
EPS (Rs)	19.2	19.7	2.5%
O/S shares (in crore)	12.5	13.8	10.8%

Source: Company

Post Amalgamation Balance Sheet for 9MFY2021 Rs crore

Particulars	APL Apollo Tubes (Consolidated)	APL Apollo Tubes (Merged + Consolidated)
Net Fixed Assets	1,631	1,620
Capital Reserve/Goodwill	138	280
Non-Current Investment	1	1
Long-term loans & advances	0	0
Other non-current assets	144	144
Non-current assets (A)	**1,914**	**2,045**
Current Assets (B)	**1,151**	**1,151**
Total Assets (A+B)	**3,065**	**3,196**
Equity Share capital	25	28
Reserves & Surplus	1,667	1,795
Net worth (A)	**1,692**	**1,823**
Non-Current Liabilities (B)	**413**	**412**
Current Liabilities (C)	**960**	**960**
Total Liabilities	**3,065**	**3,196**

Source: Company

Management expects merger synergies across cost, product offering, and branding

Management is optimistic of synergy benefits with reduction in cost (lower distribution cost and plant consolidation), product offering (benefit of cross-selling of products such as Tricoat products in West and Eastern region) and brand equity. Management guided for minimum accretion of Rs. 150/tonne in EBITDA margin from Q3FY2021 level. Management is focused on expanding warehousing capacity and penetrate into new geographies of west and east especially for Tricoat products. Moreover, management expects the merger to drive fast capacity expansion (brownfield expansion would make the products available in nine months, while greenfield expansion would require 2-2.5 years) and better utilisation level, which would help drive sustainable high double-digit volume growth for APL.

Cost synergies – Management is focused on consolidation of manufacturing units, as APL has six plants and Tricoat has two plants (one in NCR and another in Bangalore). Cost synergies would be in the form of lower distribution cost and marketing expenses.

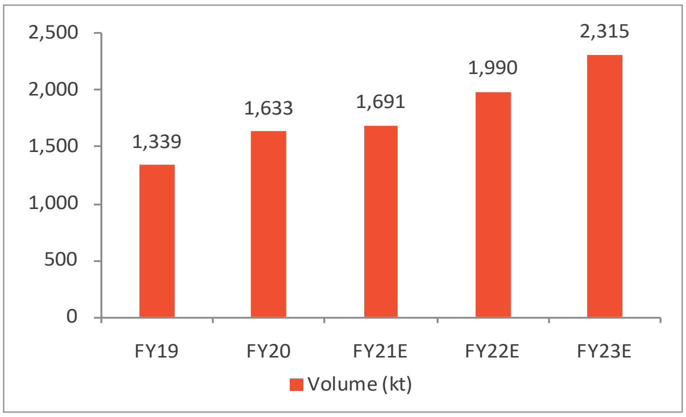
Product synergies – Both APL and Apollo Tricoat will complement each other's products and would have one marketing strategy. Merger would provide single platform for innovation of new application for structural steel tubes (home innovation, heavy structural tube, home decor tubes) and provides strong volume growth opportunities.

Brand synergies – Management expects lot of efficiencies in terms of product branding for the merged entity. Management is in discussions with consultants for single brand for both APL Apollo Tubes and Apollo Tricoat.

Timeline for synergies – Management has guided 12-18 months' time frame for synergies to flow to P&L post implementation of merger. The synergy benefit from saving in distribution cost is expected to be visible in 6 months post-merger while product synergies would be available on immediate basis, and brand synergies are a low hanging fruit for APL.

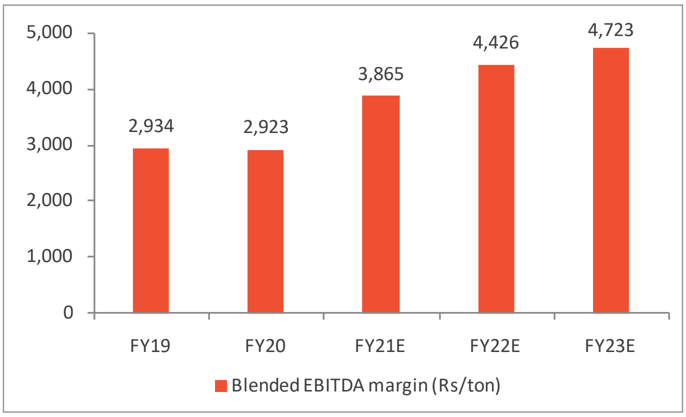
Financials in charts

Volume to post a 17% CAGR over FY2021E-FY2023E



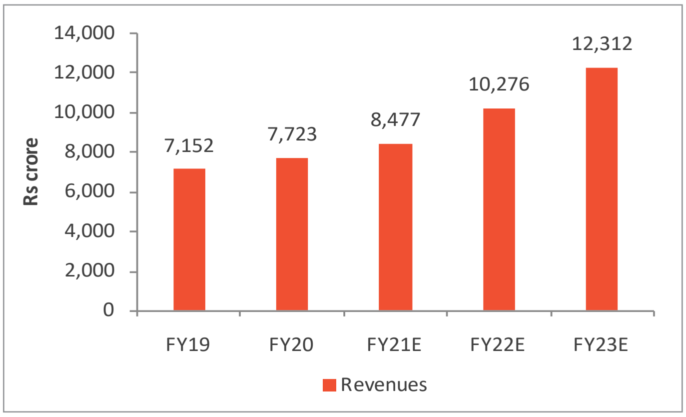
Source: Company, Sharekhan Research

Margin expansion given rise in share of high-margin products



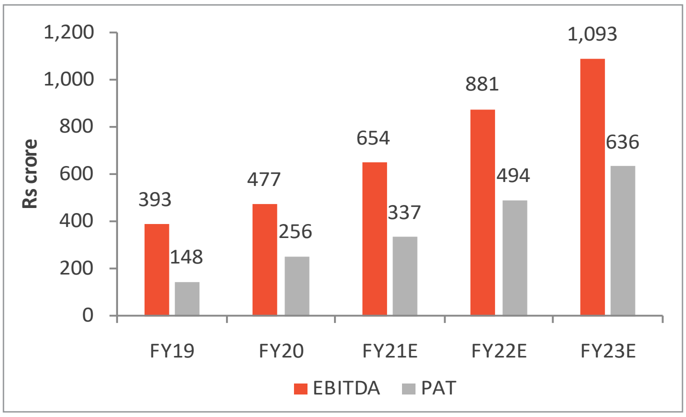
Source: Company, Sharekhan Research

Revenue trend



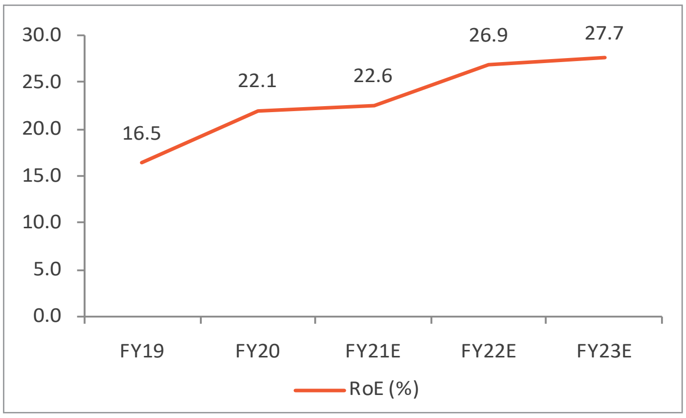
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 29%/37% over FY2021E-FY2023E



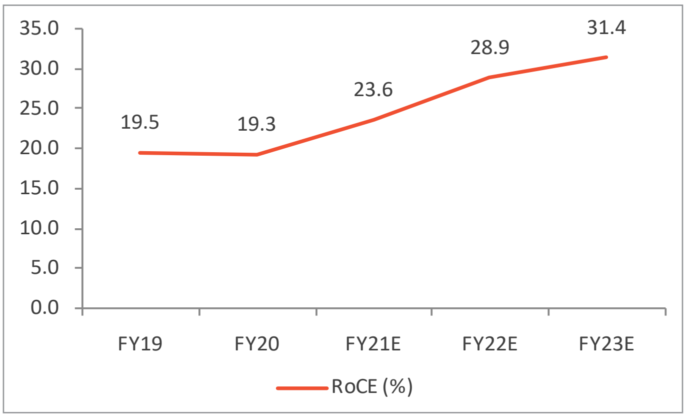
Source: Company, Sharekhan Research

Robust RoE



Source: Company, Sharekhan Research

RoCE track record



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Structural steel tubes market size to report a 10% CAGR over FY2021E-FY2024E, led by higher demand:**

The structural steel tubes market has posted a 7% CAGR over FY2017-FY2020 and is estimated at ~4 million tonne in FY2020. Demand outlook seems robust, supported by government focus on infrastructure spending and rising application of structured steel in housing and commercial buildings. With strong demand, we expect the share of structured steel in India's overall steel consumption pie to increase significantly in the next 4-5 years from 4% currently. Overall, we expect the structural steel tubes market to post a 10% CAGR over FY2021E-FY2024E and reach ~5 million tonne by FY2024E.

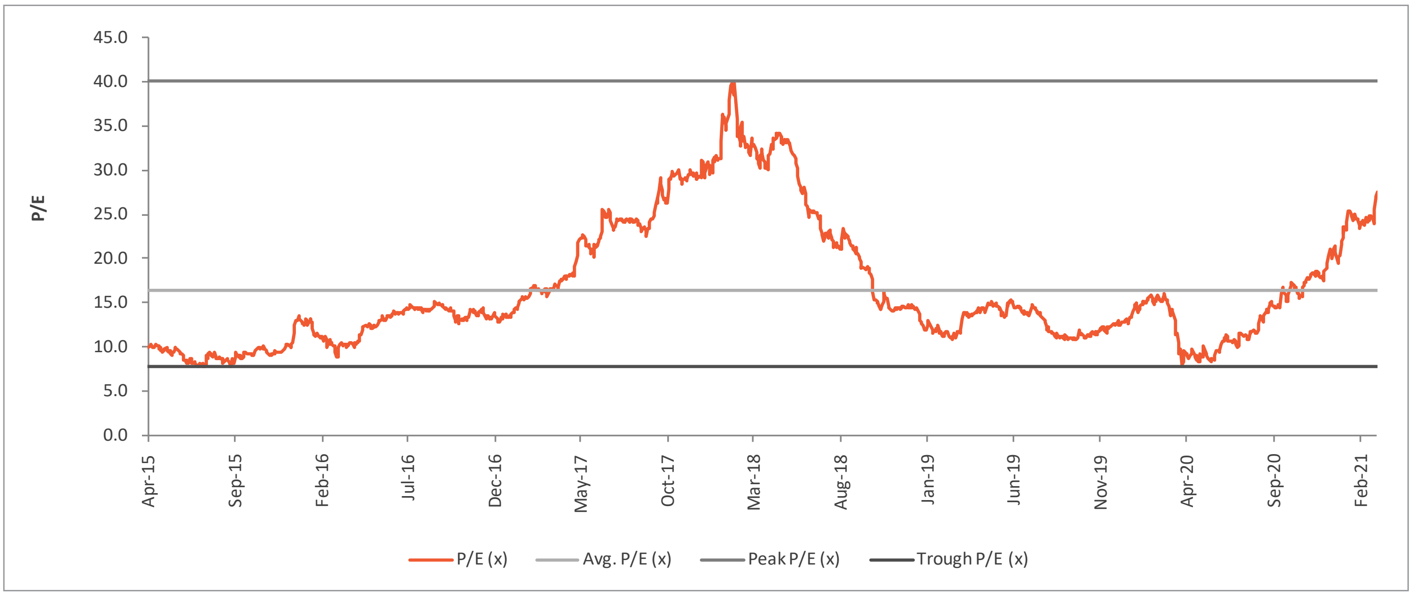
■ **Company outlook - Sustainable earnings growth led by structural volume growth drivers and potential margin expansion:**

APL's volumes reported a 21% CAGR over FY2017-FY2020, led by market share gains of 1,200 bps to 40% in FY2020. Structural demand drivers for structural steel tubes (expected to post a 10% CAGR over FY2021E-FY2024E) and weak competition given fragmented industry structure would help APL further expand its market share over the next few years. Hence, we expect robust 17% volume CAGR over FY2021E-FY2023E and reach 2.3 million tonne by FY2023E. Moreover, premiumisation and cost reduction would expand EBITDA margin by 62% to Rs. 4,723/tonne in FY2023E as compared to Rs. 2,923/tonne in FY2020. Industry-leading volume growth and strong margins are likely to result in sustained outperformance in earnings versus peers in the medium to long term.

■ **Valuation - Maintain Buy on APL with a revised PT of Rs. 1,330**

We maintain our FY2021-FY2023 earnings estimates as we wait exact details on merger synergies from management and regulatory approvals are also pending. We believe the merger is the right step to simplify the corporate structure and would improve margin/RoE profile (Tricoat RoE of 40%). Improved quality of earnings, focus to penetrate the home décor category, and brand building could further re-rate APL. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,330 (valued at 26x FY2023E EPS; revision in PT reflects higher PE multiple). At the CMP, the stock is trading at 27.5x its FY2023E EPS and 21.4x its FY2023E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

APL is the largest structural tubes manufacturer in India with a market share of 50%. The company has consistently expanded its capacity from 53,000 tpa in FY2006 to 2.5 mtpa in FY2020 through the organic and inorganic route. APL is present across India with plants in northern, western, central, and southern regions. The company also has a distribution network of 800 distributors and over 50,000 retailers. The company derives 48% of its volume from building material housing, 26% from building material commercial, 21% from infrastructure, and 5% from industrial and agricultural sectors.

Investment theme

Structural steel share in overall steel consumption in India is one of the lowest in the world at ~4% in FY2020 as compared to global average of 9%. With rising demand from housing and infrastructure projects, we expect the structural steel market to witness a 10% CAGR over FY2021E-FY2023E and reach 5mt by FY2023E. APL, a market leader in the segment, would be key beneficiary of rising demand and potential market share gain over the next couple of years. Thus, we expect sustained volume-led strong earnings growth for APL.

Key Risks

- Any rise in competition from well-established steel companies could impact volume growth and impact working capital cycle.
- Delayed recovery in demand from construction and infrastructure projects could hurt earnings outlook.
- Substantial rise in steel price could impact margin outlook.

Additional Data

Key management personnel

Sanjay Gupta	Chairman
Arun Agarwal	Chief Operating Officer
Deepak Kumar Goyal	Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	PIIN Kitara	8.1
2	FIL Ltd	3.9
3	Kitara PIIN 1101	3.4
4	RB Diversified Pvt Ltd	2.4
5	Sampat Sameer Mahendra	2.3
6	ICICI Prudential Life Insurance Co	2.1
7	Vanguard Group Inc/The	2.0
8	Kotak Mahindra Asset Management Co	2.0
9	Goldman Sachs Group Inc/The	1.7
10	DSP Investment Managers Pvt Ltd	1.6

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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