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Stock Update

APL Apollo Tubes Limited

Robust Q4 margin; Well-placed for sustained high growth

Building Materials	Sharekhan code: APLAPOLLO	Result 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. 1,333**	
Price Target: **Rs. 1,620**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

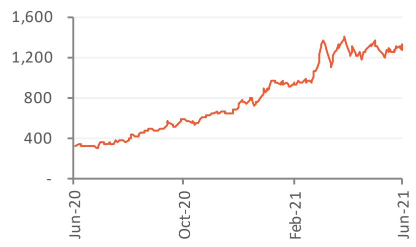
Company details

Market cap:	Rs. 16,643 cr
52-week high/low:	Rs. 1,446/304
NSE volume: (No of shares)	3.4 lakh
BSE code:	533758
NSE code:	APLAPOLLO
Free float: (No of shares)	7.9 cr

Shareholding (%)

Promoters	37.0
FII	24.2
DII	10.0
Others	28.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1	1	80	326
Relative to Sensex	-7	-1	64	273

Sharekhan Research, Bloomberg

Summary

- Q4FY2021 operating profit/PAT at Rs. 206 crore/Rs. 119 crore, up 72%/110% y-o-y and beat of 16%/22% versus our estimate led by margin outperformance at Rs. 4,742/tonne due to high share of VAP at 60%.
- Management has guided for 10%-15% volume growth for FY2022 if there is no third wave of COVID-19; Margin guidance of above Rs. 5,000/tonne for existing capacity and Rs. 6,000-7,000/tonne for new products such as color pipe tubes.
- Target to expand capacity by 57% to 4mtpa by FY2025 with focus on VAP portfolio and confident to achieve double-digit volume growth in non-pandemic period. Tricoat merger/Raipur expansion (0.4 mtpa) to get completed by December 2021.
- We retain Buy on APL with a revised PT of Rs. 1,620, given expectation of strong 39% PAT CAGR over FY2021-FY2023E and high RoE of 29%. APL is well placed to benefit from rising share of structured steel tubes in India's steel consumption.

APL Apollo Tubes Limited (APL) reported strong Q4FY2021 results with 16% beat in operating profit at Rs. 206 crore (up 72.2% y-o-y; down 11.1% q-o-q) versus our estimate of Rs. 178 crore. Higher-than-expected operating profit was led by 16% beat in EBITDA margin of Rs. 4,742/tonne (up 58.5% y-o-y) on account of rise in gross margin at Rs. 8,904/tonne (up 18.2% y-o-y; up 4.5% q-o-q) and cost control measures (opex down by 8.3% y-o-y on a per tonne basis). Robust gross margin was supported by sustained high share of value-added products (VAP) at 60% in Q4FY2021. Sales volumes increased by 8.7% y-o-y but declined by 10.3% q-o-q to 435 kt (in line with estimates), as there was some breather in demand in January-February and volume could have been at 490 kt-500 kt in the normal situation. PAT (after minority interest) at Rs. 119 crore (up 110% y-o-y) was 22% above our estimate of Rs. 98 crore, primarily led by beat in margins, higher other income (up 52% y-o-y), and marginally lower tax rate at 24.2%. Management has guided for 10%-15% volume growth in FY2022 in case there is no third wave of COVID-19 and expects margin to sustain at Rs. 5,000/tonne for existing capacities, while new products (like color pipe tubes) will have margin of Rs. 6,000-7,000/tonne. Management is optimistic of long-term growth prospects for structured steel tubes (guided for double digit volume growth in on pandemic period) and plans to expand its capacity further to 4 mtpa (from 2.6 mtpa currently). The capacity expansion of 0.4 mtpa capacity (colour pipe tubes and 500 square new lines) at Raipur is expected to be completed by December 2021. Merger of Apollo Tricoat with the company is expected to get completed by December 2021 subject to regulatory approvals. We expect APL to continue with its strong earnings growth trajectory (expect a 39% PAT CAGR over FY2021-FY2023E), supported by sustained high volume growth outlook (given rising application of structured steel tubes and innovative product launches) and continuous margin expansion. Improved earnings quality post Tricoat's merger (potentially high margin/RoE), focus to penetrate in the home décor category, brand building, and strong balance sheet (low WC capital cycle, negligible debt, and high RoE of 29%) could further re-rate APL. Hence, we maintain our Buy rating on APL with a revised price target (PT) of Rs. 1,620. At the CMP, the stock is trading at 33.6x its FY2022E EPS and 23.9x its FY2023E EPS.

Key positives

- Better-than-expected EBITDA margin at 4,742/tonne (up 58.5% y-o-y), led by higher gross margin and lower operating cost.
- A sharp increase in operating cash flow/free cash flow (FCF) by 92%/235% y-o-y to Rs. 977 crore/Rs. 697 crore.

Key negatives

- Volume declined by 10.3% q-o-q to 435kt.

Our Call

Valuation – Maintain Buy on APL with a revised PT of Rs. 1,620: We have largely maintained our FY2022 earnings estimate as lower volume assumption gets offset by higher margin assumption and have increased our FY2023 earnings estimate to reflect improving margins (given rising of high margin VAP). We have also introduced our FY2024 earnings estimate in this report. APL is well placed to benefit from rising share of structured steel tubes in overall steel consumption in India as its capacity plan would help gain further market gain and sustain high double-digit volume growth in the non-pandemic period. APL's presence in the niche business, first-mover advantage (introduction of innovative first of its kind products) in the structural steel tubes space, and improved earnings quality post likely Tricoat merger could further re-rate APL. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,620 (reflects upward revision in earnings and higher PE multiple). At the CMP, the stock is trading at 33.6x its FY2022E EPS and 23.9x its FY2023E EPS.

Key risk

- Delayed recovery in demand from construction and infrastructure projects 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	FY20	FY21	FY22E	FY23E	FY24E
Revenue	7,723	8,500	9,689	12,866	15,857
OPM (%)	6.2	8.0	8.9	9.1	9.2
Adjusted PAT	256	360	496	697	893
% YoY growth	*72.7*	*40.7*	*37.6*	*40.7*	*28.1*
Adjusted EPS (Rs.)	20.6	28.8	39.7	55.8	71.5
P/E (x)	64.7	46.2	33.6	23.9	18.6
P/B (x)	12.2	9.8	7.9	6.2	4.9
EV/EBITDA (x)	36.1	24.5	19.0	13.7	10.5
RoNW (%)	22.1	23.6	26.1	29.2	29.4
RoCE (%)	19.3	25.4	29.6	34.7	36.3

Source: Company; Sharekhan estimates

Substantially higher-than-expected PAT led by beat in EBITDA margin and higher other income: Q4FY2021 results were better than expected with 16% beat in operating profit at Rs. 206 crore (up 72.2% y-o-y; down 11.1% q-o-q) versus our estimate of Rs. 178 crore. Higher-than-expected operating profit was led by 16% beat in EBITDA margin of Rs. 4,742/tonne (up 58.7% y-o-y) on account of rise in gross margin at Rs. 8,904/tonne (up 18.3% y-o-y; up 4.5% q-o-q) and cost-control measures (opex down by 8.3% y-o-y on per tonne basis). Robust gross margin was supported by sustained high share of value-added products at 60% in Q4FY2021. Sales volume increased by 8.6% y-o-y but declined by 10.3% q-o-q to 435 kt (in line with estimates) as there was some breather in demand in January-February and volume could have been at 490 kt-500 kt in the normal situation. PAT (after minority interest) at Rs. 119 crore (up 110% y-o-y) was 22% above our estimate of Rs. 98 crore primarily led by beat in margins, higher other income (up 52% y-o-y), and marginally lower tax rate at 24.2%.

Q4FY2021 conference call highlights

- **Volume and margin outlook –** Management has guided for 10%-15% y-o-y volume in FY2022 given there is no third wave of COVID-19 in India. In terms of margins, the company is confident to maintain margin above Rs. 5,000/tonne for products from exiting capacity of 2.6mtpa and in the range of Rs. 6,000-7,000/tonne for new products for products such as colour pipe tubes.
- **Long-term business outlook –** Management indicated that there is a large opportunity of growth for structured steel tubes in India because of product innovation and cost savings. Management has guided that India's structural steel tube consumption has the potential to reach 13 million tonne/22 million tonne by 2023E/2030E as compared to only 4 million tonne in 2019. Thus, the company has plans to increase its production capacity by 57% to 4 mtpa by 2025 (versus current capacity of 2.6 mtpa). The entire expanded capacity of 1.5 mtpa would be focused on high-margin innovative products (expect share of VAP to further improve to 65%-70%). Capacity expansion of 0.4 mtpa at Raipur plant is expected to get completed by December 2021 (a delay of 2-3 months due to the lockdown). New product launches of colour pipe tubes (capacity of 0.2 mtpa) and 500 square new lines for multi-storey buildings (capacity of 0.2 mtpa) would create market for the new product.
- **Demand update for structural steel tubes –** Management indicated that the impact of lockdown is largely over and, with the potential easing of lockdown norms, the company would be able to do volume of 70-90% for normal levels in Q1FY2022. The company is in talks with few states for supply of structural steel tubes for usage in hospitals, oxygen plants, and cold storage with initial volume of 2,000 tonne-3,000 tonne. The use of structured steel tubes provides 10% savings in cost and faster project completion.
- **Update on merger of Apollo Tricoat –** The company has guided to complete the merger of Apollo Tricoat with itself by December 2021, subject to government/regulatory approvals.
- **Capex plan –** Management has maintained its capex guidance of 20%-25% of EBITDA for capex or Rs. 175 crore annually over the next few years with a focus to spend a large part of capex on capacities for value-added products. Management indicated that there is no business available for acquisition in India as the company is focused on commoditisation and increased share of VAP.
- **Sharp improvement in working capital cycle –** The company has reduced net working capital to eight days in FY2021 as compared to 25 days in FY2020 as it switched over to cash and carry model. Management is confident that discipline in working capital is structural and is likely to sustain for the long term.
- **Significant reduction in debt level –** Net debt declined by sharply by 80% to Rs. 160 crore in FY2021 with net debt/equity at only 0.1x versus 0.6x in FY2020. This was led by robust FCF generation of Rs. 697 crore (up 3.4x y-o-y).

- The company maintains inventory level of only 10-12 days and, thus, do not expect any material impact from movement in steel prices (which is largely pass through to customers). Moreover, the company has long-term, raw-material sourcing agreement with steel companies and does not see any concern on raw-material supply.

Results Rs cr

Particulars	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)
Net Sales	**2,587**	**1,889**	**37.0**	**2,601**	**-0.5**
Total Expenditure	2,381	1,769	34.6	2,369	0.5
Reported operating profit	**206**	**120**	**72.2**	**232**	**-11.1**
Adjusted operating profit	**206**	**120**	**72.2**	**232**	**-11.1**
Other Income	13	8	51.7	8	51.6
Interest	14	24	-40.4	15	-2.3
Depreciation	28	25	8.0	26	5.0
Exceptional Income/(Expense)	0	0	NA	0	NA
Reported PBT	177	79	125.4	200	-11.2
Adjusted PBT	177	79	125.4	200	-11.2
Tax	43	18	140.2	51	-15.6
PAT before MI	134	61	121.1	149	-9.7
Minority Interest	15	4	282.4	17	-9.3
PAT After MI	119	57	109.8	132	-9.7
Adjusted PAT after MI	**119**	**57**	**109.8**	**132**	**-9.7**
Equity Cap (cr)	12.5	12.5		12.5	
Reported EPS (Rs.)	9.6	4.6	109.8	10.6	-9.7
Adjusted EPS (Rs.)	9.6	4.6	109.8	10.6	-9.7
Margins (%)			**BPS**		**BPS**
OPM	8.0	6.3	163	8.9	-94
Effective tax rate	24.2	22.7	148	25.4	-128
NPM	4.6	3.0	160	5.1	-47

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)
Volume (kt)	435	401	8.7%	486	-10.3%
Realisation (Rs./ton)	59,423	47,140	26.1%	53,563	10.9%
Gross margin (Rs./ton)	8,904	7,532	18.2%	8,523	4.5%
EBITDA margin (Rs./ton)	4,742	2,992	58.5%	4,780	-0.8%

Source: Company; Sharekhan Research

Product-wise volume break-up kt

Particulars	Q1FY21	Q2FY22	Q3FY21	Q4FY21
Apollo Structural	**136**	**310**	**304**	**269**
Heavy Structures	9	21	27	38
Light Structures	8	63	83	58
General Structures	119	226	194	173
Apollo Z	**56**	**91**	**88**	**80**
Rust-proof structures	56	85	82	70
Rust-proof sheet	0	6	6	10
Apollo Tricoat	**32**	**61**	**73**	**66**
Apollo Galv	**13**	**18**	**21**	**19**
Total volume (kt)	**238**	**481**	**486**	**435**

Source: Company; Sharekhan Research

Product wise EBITDA margin Rs/ton

Particulars	Q1FY21	Q2FY22	Q3FY21	Q4FY21
Apollo Structural				
Heavy Structures	3,900	4,200	5,000	5,012
Light Structures	3,600	4,000	5,100	5,106
General Structures	1,143	1,382	1,993	1,996
Apollo Z				
Rust-proof structures	5,300	6,236	7,654	7,708
Rust-proof sheet	4,556	456	4,760	4,804
Apollo Tricoat	**5,786**	**6,137**	**7,872**	**7,671**
Apollo Galv	**3,491**	**5,655**	**6,950**	**6,981**
Blended margins (Rs./ tonne)	**2982**	**3,514**	**4,780**	**4,742**

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's 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 registered a 15% CAGR over FY2017-FY2021, led by market share gains of 2,200 bps to 50% in FY2021. 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 a robust 19% volume CAGR over FY2021-FY2023E and reach 2.3 million tonne by FY2023E. Moreover, premiumisation and cost reduction would expand EBITDA margin by 20% to Rs. 4,976/tonne in FY2023E as compared to Rs. 4,138/tonne in FY2021. 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. 1,620**

We have largely maintained our FY2022 earnings estimate as lower volume assumption gets offset by higher margin assumption and have increased our FY2023 earnings estimate to reflect improving margins (given rising of high margin VAP). We have also introduced our FY2024 earnings estimate in this report. APL is well placed to benefit from rising share of structured steel tubes in overall steel consumption in India as its capacity plan would help gain further market gain and sustain high double-digit volume growth in the non-pandemic period. APL's presence in the niche business, first-mover advantage (introduction of innovative first of its kind products) in the structural steel tubes space, and improved earnings quality post likely Tricoat merger could further re-rate APL. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,620 (reflects upward revision in earnings and higher PE multiple). At the CMP, the stock is trading at 33.6x its FY2022E EPS and 23.9x 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.

Additional Data

Key management personnel

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc.	4.5
2	SMALLCAP World Fund Inc	4.4
3	FIL Ltd.	4.0
4	Vanguard Group Inc.	2.1
5	ICICI Prudential Life Insurance	1.9
6	Kotak Mahindra Asset Managemnt Co. Ltd	1.8
7	Goldman Sachs Group Inc.	1.2
8	Caisse de Depot et Placement du Quebec	1.2
9	Taiyo Greater India Fund L	1.2
10	Fidelity Funds SICAV	1.2

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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