Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

APL Apollo Tubes Ltd

Crafting a profitable & sustainable growth model

Building Material	Sharekhan code: APLAPOLLO
Reco/View: Buy ↔	CMP: **Rs. 918** / Price Target: **Rs. 1,100** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- APL Apollo Tubes (APL) strategy of developing and creating a market for new products places it well to grab the lion's share of massive growth opportunity in specialty steel tubes industry (expected to clock a 17% CAGR over CY21-30E). We expect APL's volume to grow at 20% CAGR over FY21-24E.
- Global peers have margins of 14-19% in structural steel tubes space, while APL's margins are at 8%. This provides scope for margin expansion, which management expects to reach Rs. 6,000-7,000/tonne (from Rs. 5,000/tonne) with rise in share of VAP to 75% from 62% currently. For every Rs. 500/tonne rise in margin our FY24E EBITDA increases by 9%.
- Overall, we expect APL to sustain industry leading volume growth and continued margin improvement, which would drive a strong 37% PAT CAGR over FY21-24E along with high RoE/RoCE of 30%/36%.
- We maintain our Buy rating on APL Apollo Tubes and raise the PT to Rs. 1,100 (higher PE multiple of 30x FY24E EPS) as we expect its valuation gap with players like Astral to narrow down given structural earnings growth drivers and likely improvement in earnings quality after the Tricoat merger.

APL's dominant market position, proposed capacity expansion to 4mtpa (from 2.6mtpa currently) and planned innovative product launches (500 square columns for high-rise buildings, Pre-Engineered Buildings for heavy infrastructure and colour coated tubes for interior furniture applications) makes it key beneficiary of potential increase in the share of specialty steel tubes to ~10% by 2030 and drive industry leading volume CAGR of 20% over FY21-24E. Moreover, the company's target to increase share of value-added products (VAP) to 75% would help further expand margins to Rs. 6,000-7,000/tonne post 2x rise seen in the last two years. Hence, we expect APL's revenue/EBITDA/PAT to post robust 23%/30%/37% CAGR over FY21-24E.

- **Rising application of steel tubes to drive volume growth and aid gain market share:** Penetration of structural steel tubes in real estate/infrastructure construction in India is quite low at 10-15% and we believe that the usage of the same is expected to increase exponentially in the years to come given imminent cost saving from lower construction time (RCC structures requires 2-3 years versus 12-18 months for steel structures). Thus, the share of structured steel tubes in India's overall steel consumption has potential to reach global average of 10% by 2030 versus only 4% currently, which translated into robust 17% CAGR over CY19-30E. APL's recent project win to supply structured steel tubes for construction of 7 hospital is Delhi is an indication of shifting trend from RCC structures to steel structures.
- **APL's strategy to develop & create a market for products would aid further market share gain and high-volume growth:** APL plans to launch products namely 500 sq columns for high-rise buildings, PEB (Pre-Engineered Buildings) for heavy infrastructure like airport etc and colour coated tubes for interior furniture applications. The management expects that new products would have high market share of 70-80% given a first-mover advantage. Thus, we see scope for further market share gain from current level of 50% and superior volume CAGR of 20% over FY21-24E.
- **Focus on VAP to drive margin expansion:** APL has consistently increased share of VAP in its sales mix to 64% in H1FY22 versus 42% in FY19 and targets to take it to 75% as all incremental capacities would largely be focused on value-added products. Global peers have margin of 14-19% in structural steel tubes space while APL's margins are at 8% currently. This provides scope for margin expansions, which management expects to reach Rs. 6,000-7000/tonne (from Rs. 5,000/tonne currently) with rise in share of VAP in volume mix. Our sensitivity analysis suggests that every Rs. 500/tonne increase in EBITDA margin would result in 9% rise (or incremental Rs. 140 crore) in our FY24E EBITDA estimates.

Our Call

Valuation – Maintain Buy on APL with a revised PT of Rs. 1,100: APL's presence in a niche business, first-mover advantage (introduction of innovative, first-of-its-kind products) in the structural steel tubes space and improved earnings quality (potential margin/RoE improvement) post the likely merger of Tricoat could help reduce valuation gap with listed building material companies (APL trades at 25x FY2024E EPS as compared to valuation of 55x for players like Astral Limited). We thus, value APL at a higher P/E multiple of 30x FY24E EPS and increase our price target to Rs. 1,100 and maintain our Buy rating on the stock.

Key Risks

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

Valuation (Consolidated)

Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	8,500	9,689	12,866	15,857
OPM (%)	8.0	9.9	9.4	9.4
Adjusted PAT	360	560	725	920
% YoY growth	*40.7*	*55.4*	*29.6*	*26.8*
Adjusted EPS (Rs.)	14.4	22.4	29.0	36.8
P/E (x)	63.7	41.0	31.6	24.9
P/B (x)	13.5	10.6	8.3	6.5
EV/EBITDA (x)	33.9	23.6	18.4	14.4
RoNW (%)	23.6	29.1	29.6	29.4
RoCE (%)	25.4	32.9	35.2	36.4

Source: Company; Sharekhan estimates

3R MATRIX

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		↔	

ESG Disclosure Score

NEW

ESG RISK RATING 43.72

Updated Oct 08, 2021

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

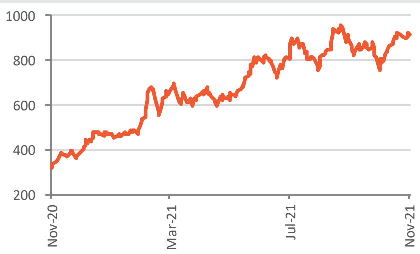
Company details

Market cap:	Rs. 22,956 cr
52-week high/low:	Rs. 1,050 / 316
NSE volume: (No of shares)	4.4 lakh
BSE code:	533758
NSE code:	APLAPOLLO
Free float: (No of shares)	15.8 cr

Shareholding (%)

Promoters	36.8
FII	25.2
DII	8.4
Others	29.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14	13	47	189
Relative to Sensex	18	8	32	156

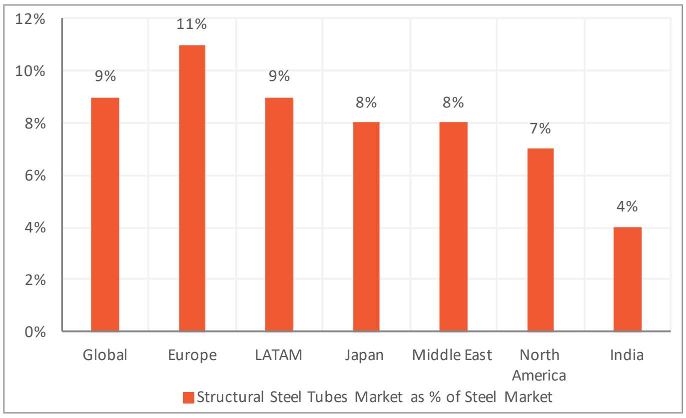
Sharekhan Research, Bloomberg

APL's dominant position to aid industry leading volume growth – expect 20% volume CAGR over FY21-24E

India's consumption of structural steel tubes is estimated at ~4mt and its share in country's steel consumption ay just 4% is significantly below the global average of 9-10%. We see four pillars of growth in structural steel tubes in India – 1) expansion in warehousing capacity to , 2) Affordable housing, 3) urban infrastructure and 4) urban real estate. The increasing application of structured steel tubes in construction projects is expected to expand the share of structural steel tubes in India's steel consumption to 10% by 2030. This would expand India's structural market to 22 mt by 2030, which implies robust 17% CAGR over CY19-30E.

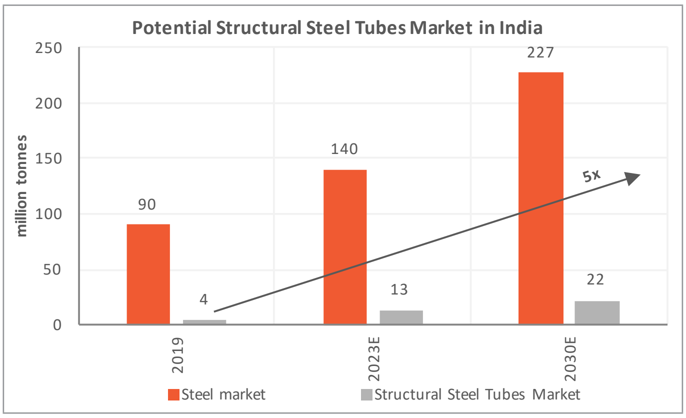
We believe APL is well placed to grab this massive volume opportunity given presence across India, spare capacity (utilisation rate of 64%) & further capacity expansion to 4mtpa (from 2.6 mtpa currently), product launches (500 sq columns for high-rise building, PEB for infrastructure and colour coated tubes for interior furniture applications). Additionally, APL's recent project win to supply structured steel tubes for construction of seven hospitals is Delhi is an indication of shifting trend from RCC structures to steel structures. Thus, we see scope for further market share gain from current level of 50% and superior volume CAGR of 20% over FY21-24E.

Structured steel share at 4% of steel consumption vs. global average of 9%



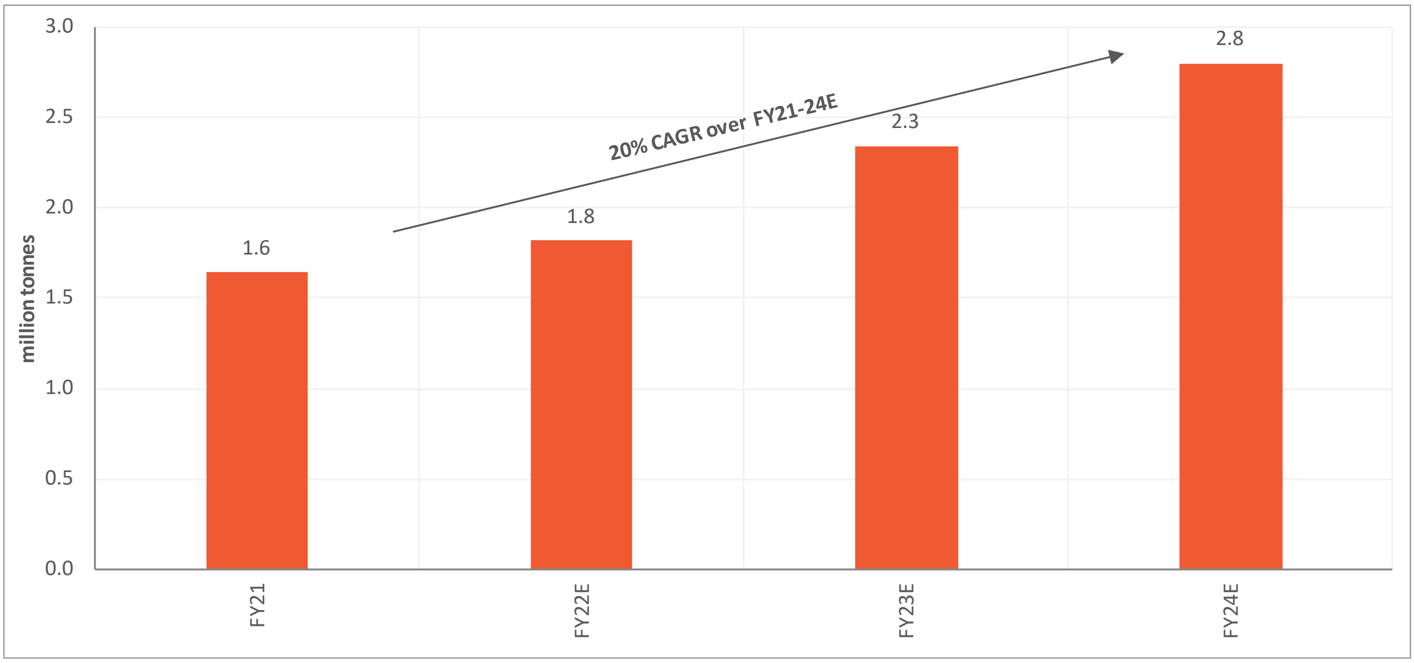
Source: Company, Sharekhan Research

Structured steel market to grow 5x over CY19-30E



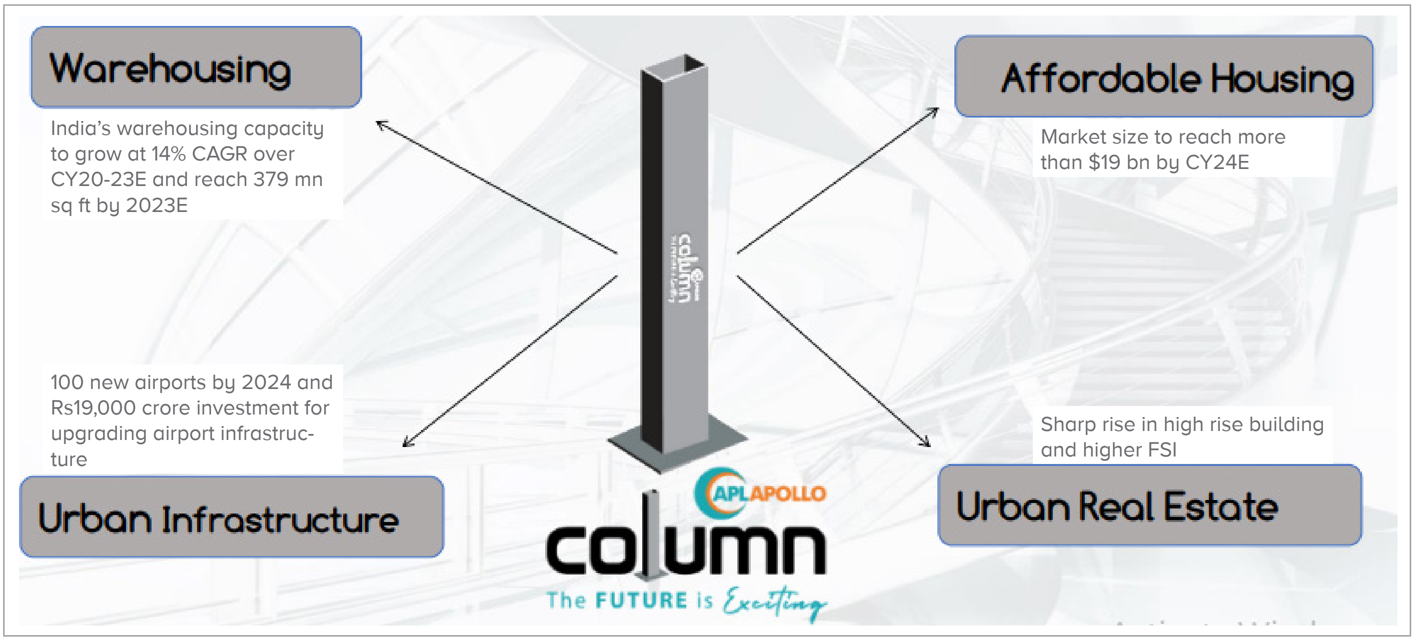
Source: Company, Sharekhan Research

APL volume expected to grow at 20% CAGR over FY21-24E



Source: Company; Sharekhan Research

Four growth pillars for structural steel demand in India



Source: Company; Sharekhan Research

Develop & create market for new products

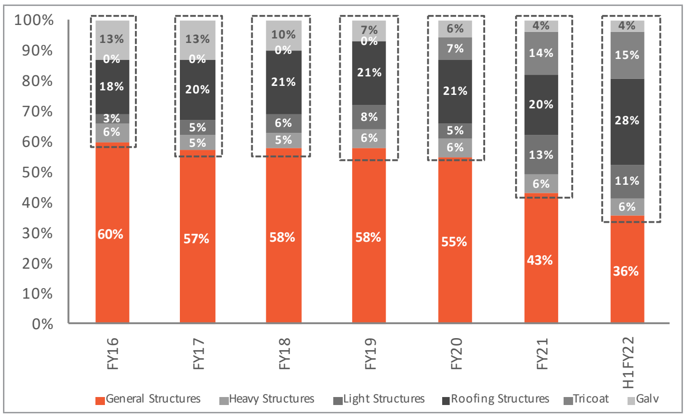
Planned new product launches	Application
500 sq columns	High-rise building
Pre-Engineered Buildings	Heavy infrastructure like airport
Colour coated tubes	Interior furniture

Source: Company; Sharekhan Research

Rising share of VAP + operating leverage to help improve margin

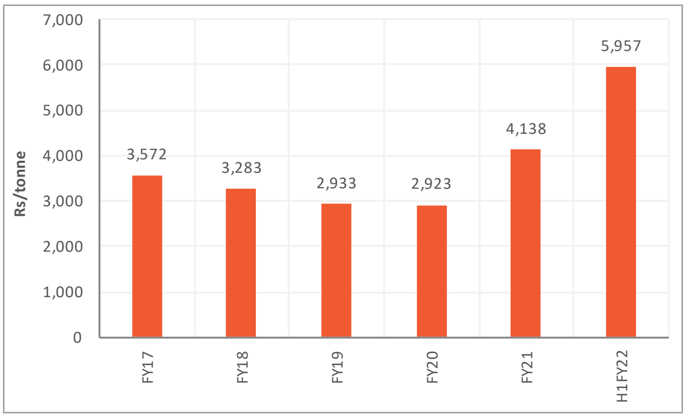
Rising share of high-margin products (EBITDA margin of Rs. 4,000-6,000/mt) like pre-galvanised tubes, galvanised tubes, and Apollo Tricoat would result into increased proportion of high value-added products in overall volume mix to 75% over next couple of years from 64% in H1FY2022. This coupled with improvement in plant utilisation factor (given higher sales volume on account of market share gain) would provide benefit of operating leverage and rationalisation of cost to help expand margins. Hence, we expect APL to sustain recent improvement seen in EBITDA margin and model margin of Rs. 5,341/tonne in FY2024E as compared to Rs. 4,138/tonne in FY2021. Global peers have margin of 14-19% in structural steel tubes while APL's margins are at 8% currently. This provides scope for margin expansion, which management expects to reach Rs. 6,000-7000/tonne (from Rs. 5,000/tonne currently) with rise in share of VAP in volume mix. Hence, we see significant upside to our margin assumption and highlight here that for every Rs. 500/tonne increase in margin our FY24E EBITDA would rise by 9%.

Rising share of VAP to aid margin



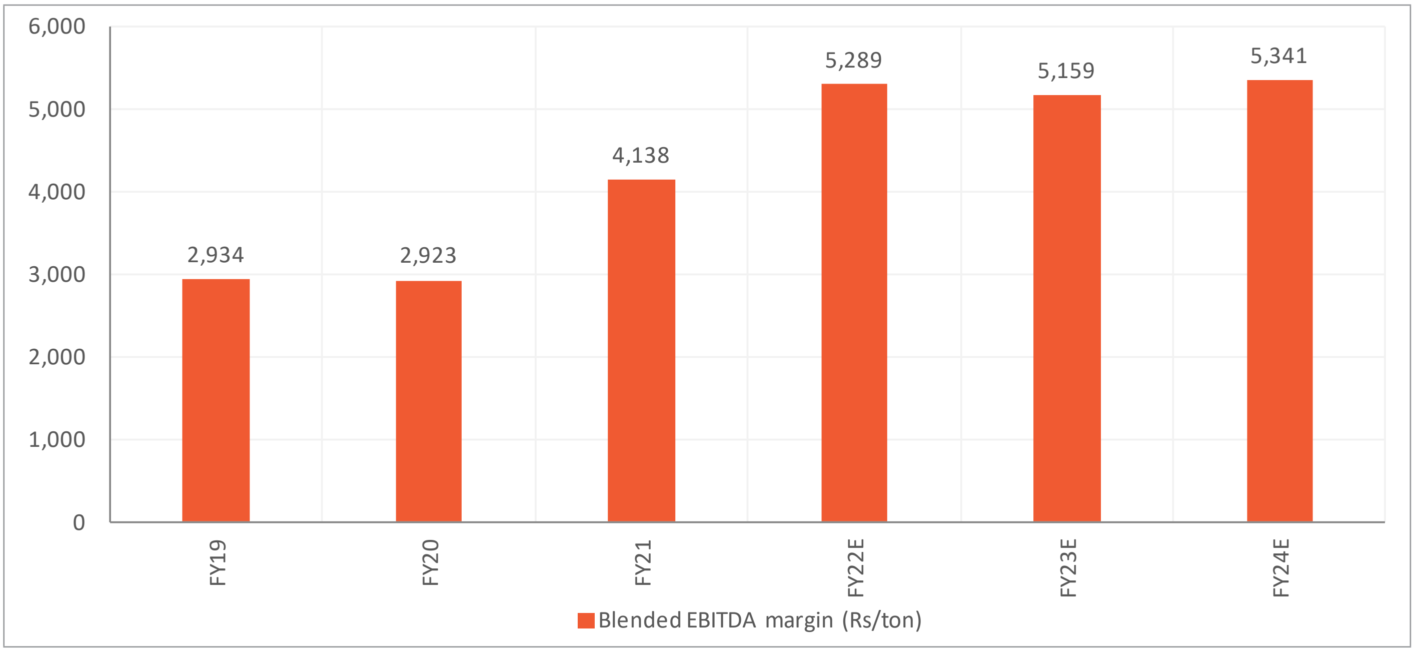
Source: Company, Sharekhan Research

EBITDA margin witnessed 2x rise in last two years



Source: Company, Sharekhan Research

EBITDA margin to improve by 29% to Rs. 5,341/tonne over FY21-24E; still at half the margin of global pers



Source: Company; Sharekhan Research

Global peer comparison – APL's margin significantly lower than peers

Particulars	FY21 Revenue (Rs. bn)	Margin	Capacity (mn tonnes)
SSAB	68	14%	1.1
Maruichi	105	17%	1.4
Zekelman	185	19%	2.8
APL Apollo	85	8%	2.6

Source: Company; Sharekhan Research

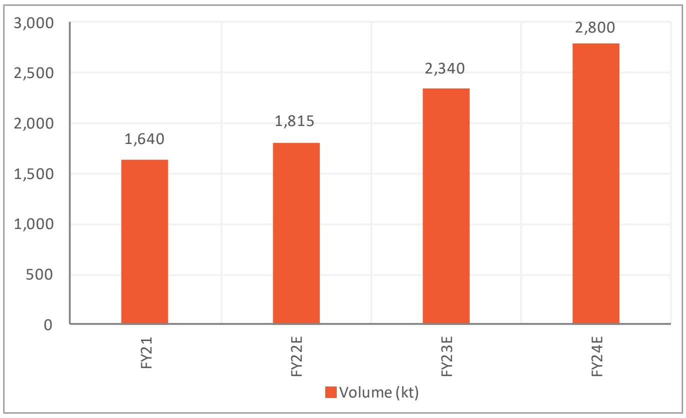
Sensitivity analysis – for every Rs. 500/tonne increase in margin our FY24E EBITDA would side by ~9%

		EBITDA Margin (Rs. /tonne)				
		4,341	4,841	**5,341**	5,841	6,341
Volume (kt)	2,200	955	1065	1175	1285	1395
	2,500	1085	1210	1335	1460	1585
	2,800	1216	1356	**1496**	1636	1776
	3,100	1346	1501	1656	1811	1966
	3,400	1476	1646	1816	1986	2156

Source: Sharekhan Research

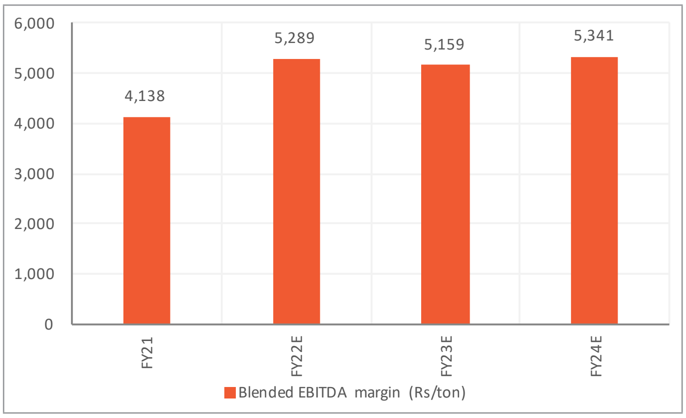
Financials in charts

Volume to post a 20% CAGR over FY2021-FY2024E



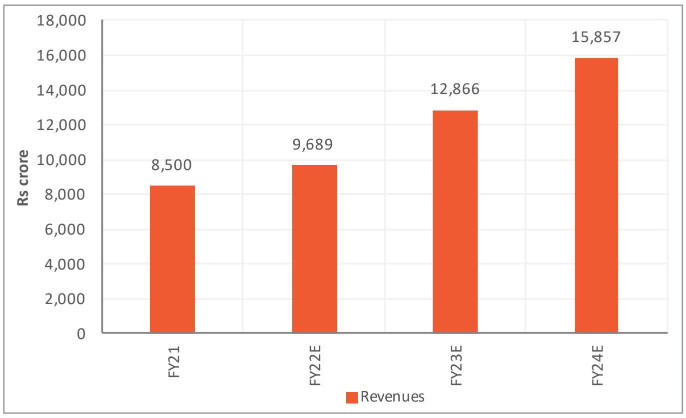
Source: Company, Sharekhan Research

Margin expansion given rise in share of high-margin products



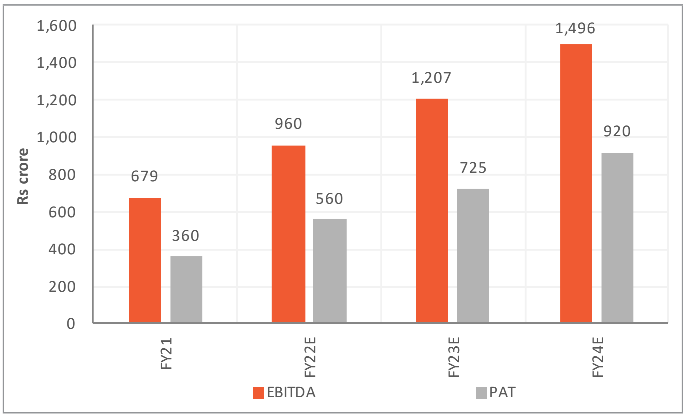
Source: Company, Sharekhan Research

Revenue trend



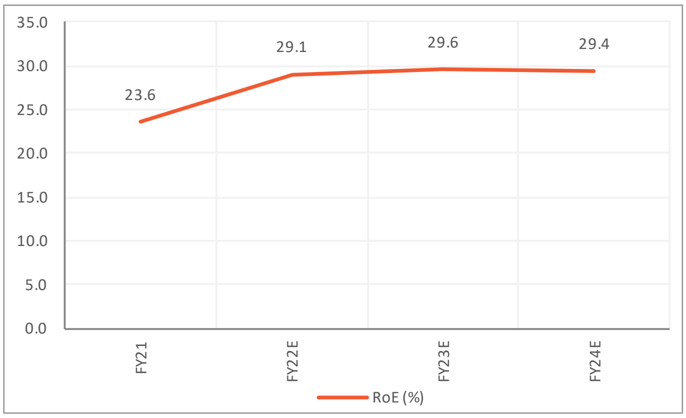
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 30%/37% over FY2021-FY2024E



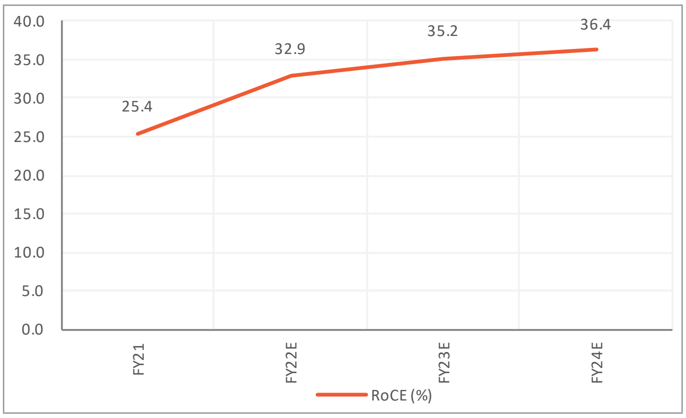
Source: Company, Sharekhan Research

Robust RoE track record



Source: Company, Sharekhan Research

RoCE improving consistently



Source: Company, Sharekhan Research

Outlook and Valuation

- **Sector view – Structural steel tubes market size to report a 17% CAGR over 2019-2030E, led by higher demand from construction projects:** The structural steel tubes market has posted a 7% CAGR over 2017-2019 and is estimated at ~4 million tonnes in CY2019. Demand outlook seems robust, supported by the government's focus on infrastructure spending and rising applications 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 to 10% by CY2030 from 4% in CY2019. Overall, we expect the structural steel tubes market to post a 17% CAGR over 2019-2030E and reach ~22 million tonnes by CY2030E.

- **Company outlook – Sustainable earnings growth led by structural volume growth drivers and potential margin expansion:** APL's volumes clocked a 15% CAGR over FY2017-FY2021, led by market share gains of 2,200 bps to 50% in FY2021. Demand drivers for structural steel tubes (expected to post a 17% CAGR over CY2019-2030E) 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 20% volume CAGR over FY2021-FY2023E and reach 2.8 million tonnes by FY2024E. Moreover, premiumisation and cost reduction would expand EBITDA margin by 29% to Rs. 5,341/tonnes in FY2024E 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 (expect 37% PAT CAGE over FY21-24E) versus peers in the medium to long term.

- **Valuation – Maintain Buy on APL with a revised PT of Rs. 1,100:** APL's presence in a niche business, first-mover advantage (introduction of innovative, first-of-its-kind products) in the structural steel tubes space and improved earnings quality (potential margin/RoE improvement) post the likely merger of Tricoat could help reduce valuation gap with listed building material companies (APL trades at 25x FY2024E EPS as compared to valuation of 55x for players like Astral Limited). We thus, value APL at a higher P/E multiple of 30x FY24E EPS and increase our price target to Rs. 1,100 and maintain our Buy rating on the stock.

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 CY2019 as compared to global average of 9-10%. With rising demand from housing and infrastructure projects, we expect the structural steel market to witness a 10% CAGR over FY2021EP-FY2024E and reach 5mt by FY2024E. 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	Piin Kitara	7.7
2	SmallCap World Fund Inc./Fund Parent	5.8
3	Capital Group Cos Inc./The	5.8
4	Sampat Sameer Mahendra	2.3
5	Gupta Veera	2.2
6	Vanguard Group Inc.	2.0
7	ICICI Prudential Life Insurance Co. Ltd	2.0
8	Kotak Mahindra Asset Management Co. Ltd/ India	1.7
9	New Capital Fund Management Ltd.	1.6
10	FIL Ltd	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

Sharekhan

by BNP PARIBAS

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