Equity Research

March 22, 2022

BSE Sensex: 57292

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Company update

Metal tubes

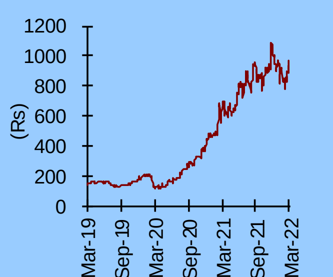
Target price: Rs1,110

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	36.8	36.8	34.5
Institutional investors	35.1	33.7	35.3
MFs and others	5.3	4.6	6.7
FI/Banks	3.5	3.3	3.3
FIIs	25.7	25.8	25.3
Others	28.1	29.5	30.2

Source: CMIE

Price chart



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INDIA

ICICI Securities

APL Apollo Tubes

BUY
Maintained

Proposed investment into Shankara to strengthen distribution of structural steel tubes

Rs964

APL Apollo (APL) has announced a minority equity investment proposal by its wholly owned subsidiary APL Apollo Mart Limited (Apollo Mart) into Shankara Building Products Ltd (Shankara). APL will end up owning ~9.9% of Shankara for a total investment of Rs1.8bn (~6% of APL's total capital employed as on end-Dec'21). This will be through a combination of purchase of secondary promoter shares (1mn shares @Rs755/share) and proposed preferential allotment of convertible warrants (1.4mn shares @Rs750/share). Shankara was valued at 0.9x EV/sales (FY22 annualised). The investment will be funded via internal accruals and is expected to be EPS and RoCE accretive from the very first year. APL sees an opportunity to potentially double its existing sales from Shankara. We maintain BUY on APL with a target price of Rs1,110/share.

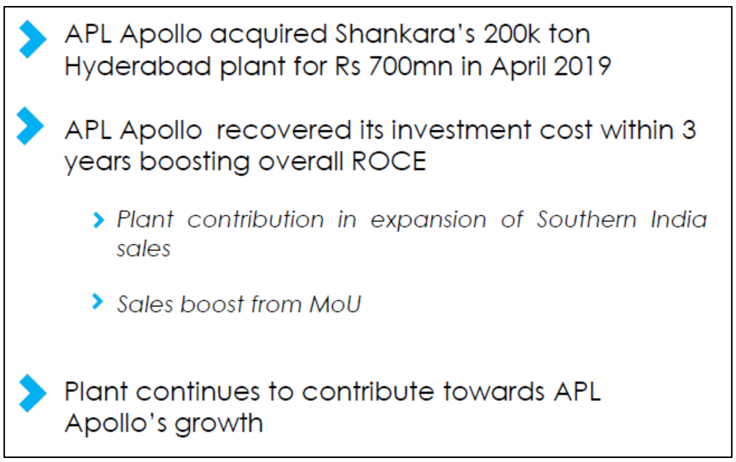
- **Investment rationale.** According to management, i) the investment is aligned with APL's growth plan, ii) Shankara would be an ideal launch platform for APL's new products, iii) there would be synergies through Shankara's retail/wholesale network, iv) expansion of the structural steel tubes market and v) association would ensure sales consistency as Shankara is amongst APL's key distributors.
- **APL Apollo + Shankara associations.** Shankara distributes ~0.1mnte of APL Apollo's volumes. In April'19, APL acquired Shankara's 0.2mnte Hyderabad plant for ~Rs700mn. APL recovered its entire investment cost within three years, boosting its overall ROCE. Current EBIDTA generation (estimated) from that plant is Rs400-500mn pa. With the current investment, management expect sales consistency to be maintained along with growth momentum. APL sees an opportunity of potentially doubling sales through Shankara using its extensive retail/wholesale network.
- **About the deal.** The investment will be made through a combination of purchase of secondary promoter shares (1mn shares @Rs755/share) and proposed preferential allotment of convertible warrants (1.4mn shares @Rs750/share), taking the total investment size to Rs1.8bn (~6% of APL Apollo's total capital employed as at end-Dec'21). Apollo Mart will make an immediate investment of ~Rs1.018bn (secondary market purchase +25% warrant subscription money) and the remaining investment of ~Rs787mn will be made within 18 months (75% on warrant conversion). Shankara was valued at 0.9x EV/sales (FY22 annualised). The target deal is expected to be completed in Q1FY23 subject to approvals. Management expects the deal to the EPS and RoCE accretive from the very first year.
- **Risks**. We haven't factored in any additional investments for strengthening the distribution/retailing framework for APL. More such investments, going forward, may have implications for future RoCE.

Market Cap	Rs241bn/US$3.2bn
Reuters/Bloomberg	APLA.BO / APAT IN
Shares Outstanding (mn)	250.3
52-week Range (Rs)	1083/593
Free Float (%)	65.5
FII (%)	25.3
Daily Volume (US$'000)	7,604
Absolute Return 3m (%)	(8.6)
Absolute Return 12m (%)	53.7
Sensex Return 3m (%)	1.9
Sensex Return 12m (%)	16.1

Year to Mar	FY21	FY22E	FY23E	FY24E
Revenue (Rs mn)	84,998	126,335	144,904	188,479
EBITDA(Rs mn)	6,787	9,074	11,121	15,618
Net Income (Rs mn)	4,238	5,957	7,670	11,462
EPS (Rs)	15.3	21.5	27.7	41.5
P/E (x)	56.2	40.0	31.1	20.8
CEPS (Rs)	19.0	26.0	32.6	46.4
EV/E (x)	35.2	26.2	21.0	14.4
Dividend Yield	-	0.4	0.5	0.7
RoCE (%)	26.3	27.7	27.6	28.7
RoE (%)	25.0	27.1	26.9	30.0

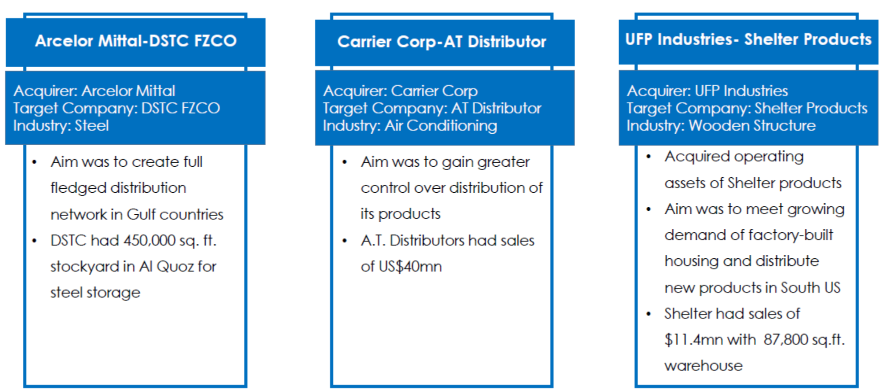
- **About Shankara Building Materials.** Shankara is one of India's leading organised retailer/wholesaler of home improvement and building products. The company achieved revenue of ~Rs22bn (annualised FY22) with steel tubes/products forming majority of sales. Shankara has presence in 10 states with a cumulative store base of 90 covering 450,000 sq. ft. The company sells over 30,000+ SKUs across the entire home construction and renovation lifecycle**.**
- **Case studies.** i). Arcelor Mittal-DSTC FZCO: Arcelor Mittal invested in DSTC FZCO with an aim to create full-fledged distribution network in Gulf countries. DSTC had 450,000 sq. ft. stockyard in Al Quoz for steel storage. ii) Carrier Corp-AT Distributor: Carrier Corp invested in AT Distributor with an aim to gain greater control over distribution of its products. A.T. Distributors had sales of US$40mn. iii) UFP Industries- Shelter Products: UFP Industries invested in Shelter Products with an aim to meet growing demand of factory-built housing and distribute new products in South US. Shelter had sales of US$11.4mn with 87,800 sq.ft. warehouse.

Chart 1: Case study – previous experience with shankara



Source: Company

Chart 2: Case study- global transactions



Source: Company

Maintain BUY

We maintain **BUY** with a target price of Rs1,110/share. This is based on 25x FY24E P/E. **The stock has seen a massive rerating in the past 18 months on the back of Tricoat acquisition, repayment of debt and steady growth.** With an improving RoE and RoCE profile (significantly higher operating leverage), higher growth driven by constant efforts towards market creation, and steady increase in market share (to reach >60% in the next 3-4 years in our view), we believe that a multiple of 25x FY24E P/E is justified.

Key risks

Key risks to our earnings and margin assumptions are: falling steel prices and normalising spreads. We believe management's assessment that drive towards value addition would lead to a normalised EBITDA of Rs5,000/te as volumes grow towards 4mtpa.

We believe that a slower-than-anticipated pickup in steel tubes market or equal marketing and distribution push by peers can lead to market share erosion / lower than expected revenue growth for APL.

Exposure to intense competition: APL operates in an industry with low entry barriers and fragmented structure. Though the company had ~50% market share in FY21, and the second-best player is less than half of APL's size, APL's operating margin has been modest at 5-8%. The ERW pipes industry is largely unorganized and inherently competitive with the presence of multiple large established players like Surya Roshni, Hi-Tech Pipes, Rama Steel Tubes, etc. Further, as ERW pipes are standardised products and do not warrant a capital-intensive manufacturing process, steel pipe/tube players with a diversified network across India can enter the market, boosting competition. Also, competition from unorganised players is high.

Financials

Table 1: Profit and Loss

	FY20	FY21	FY22E	FY23E	FY24E
Revenue	**77,232**	**84,998**	**126,335**	**144,904**	**188,479**
Material costs	65,786	71,648	108,710	123,770	160,639
Gross Margin	**11,447**	**13,350**	**17,625**	**21,133**	**27,840**
Employee costs	1,422	1,296	1,479	1,583	1,662
Other expenses	5,252	5,266	7,072	8,430	10,560
Total expenses	72,459	78,210	117,261	133,783	172,861
EBITDA	**4,773**	**6,787**	**9,074**	**11,121**	**15,618**
Depreciation	959	1,028	1,222	1,351	1,375
Other Income	222	359	427	419	973
EBIT	**4,036**	**6,119**	**8,278**	**10,189**	**15,217**
Interest	1,073	500	380	20	20
PBT	**2,963**	**5,619**	**7,898**	**10,169**	**15,197**
Tax	403	1,381	1,941	2,499	3,735
PAT	**2,560**	**4,238**	**5,957**	**7,670**	**11,462**

Source: I-Sec research

Table 2: Balance Sheet

Balance Sheet	FY20	FY21	FY22E	FY23E	FY24E
Equity Share Capital	249	250	553	553	553
Reserves and Surplus	14,267	16,697	21,450	27,960	37,688
Net Worth	**14,516**	**16,947**	**22,003**	**28,513**	**38,241**
Borrowings	7,280	4,425	4,225	225	225
Other non-current liabilities	672	755	755	755	755
Deferred Tax Liab	1,012	1,112	1,112	1,112	1,112
Total Liab	**23,480**	**23,239**	**28,095**	**30,605**	**40,333**
Gross Block	17,160	18,491	21,991	25,491	27,491
Less: Acc Dep	2,449	3,477	4,699	6,050	7,425
Net Block	**14,711**	**15,014**	**17,292**	**19,441**	**20,066**
CWIP	101	1,077	1,077	1,077	1,077
Other LT assets	3,333	3,893	3,893	3,893	3,893
Investments	152	148	148	148	148
Working Capital (Exc cash)	**4,727**	**-472**	**1,254**	**1,429**	**1,963**
Cash and Cash equivalents	456	3,579	4,432	4,618	13,186
Current Assets	**13,907**	**10,412**	**15,711**	**17,922**	**23,275**
Inventory	7,842	7,599	11,530	13,127	17,038
Receivables	4,764	1,306	1,941	2,226	2,896
Loans, Advances & others	1,302	1,507	2,239	2,569	3,341
Current Liabilities and Provisions	**9181**	**10,884**	**14,457**	**16,494**	**21,312**
Provisions	173	177	177	177	177
Total Assets	**23,480**	**23,239**	**28,095**	**30,605**	**40,333**

Source: I-Sec research

Table 3: Cashflows

	FY20	FY21	FY22E	FY23E	FY24E
PAT	2148	4263	5957	7670	11462
+ Depreciation	959	1028	1222	1351	1375
+ Non-cash items	972	360			
Working capital changes	1017	4121	(1726)	(175)	(535)
Cashflow from operations	**5096**	**9771**	**5453**	**8846**	**12302**
Investing Activities					
Capex	(3092)	(2869)	(3500)	(3500)	(2000)
Investments	(1430)	(3868)	0	0	0
Others	173	269			
Cashflow from investing activities	**(4349)**	**(6468)**	**(3500)**	**(3500)**	**(2000)**
Financing activities					
Changes in share capital	1775				
Changes in reserves & surplus	0				
Changes in debt	(949)	(3111)	(200)	(4000)	
Dividends	(411)		(901)	(1160)	(1733)
Others	(1193)	(474)			
Cashflow from financing activities	**(778)**	**(3586)**	**(1101)**	**(5160)**	**(1733)**
Net changes in cash	**(32)**	**(283)**	**852**	**186**	**8569**
FCF	**2,003**	**6,902**	**1,953**	**5,346**	**10,302**

Source: I-Sec research

Table 4: Ratios

	FY20	FY21	FY22E	FY23E	FY24E
Per Share Data (in Rs)					
Recurring EPS (Diluted)	9.3	15.3	21.5	27.7	41.5
Reported EPS	102.9	33.9	21.5	27.7	41.5
Recurring Cash EPS (Diluted)	12.7	19.0	26.0	32.6	46.4
Dividend per share (DPS) (Diluted)	1.3	-	3.3	4.2	6.3
Book Value per share (BV)	52.5	61.3	79.6	103.1	138.3
Growth Ratios (%)					
Operating Income	8.0	10.1	48.6	14.7	30.1
EBITDA	21.5	42.2	33.7	22.6	40.4
Recurring Net Income	72.7	65.5	40.6	28.8	49.4
Diluted Recurring EPS	72.7	65.5	40.6	28.8	49.4
Diluted Recurring CEPS	65.6	49.6	36.3	25.7	42.3
Valuation Ratios (% YoY)					
P/E	93.1	56.2	40.0	31.1	20.8
P/CEPS	67.7	45.3	33.2	26.4	18.6
P/BV	16.4	14.1	10.8	8.4	6.2
EV / EBITDA	51.4	35.2	26.2	21.0	14.4
EV / Operating Income	3.2	2.8	1.9	1.6	1.2
EV / Operating FCF	122.4	34.7	121.9	43.8	21.9
Operating Ratios					
Gross Margin (%)	14.8	15.7	14.0	14.6	14.8
SG&A/Sales (%)	6.8	6.2	5.6	5.8	5.6
Other Income / PBT (%)	7.5	6.4	5.4	4.1	6.4
Effective Tax Rate (%)	12.3	10.4	16.4	26.6	45.2
NWC / Total Assets (%)	20.1	(2.0)	4.5	4.7	4.9
Inventory Turnover (days)	44	39	39	39	39
Receivables (days)	6	2	2	2	2
Payables (days)	13	14	12	12	12
D/E Ratio (x)	47.0	5.0	(0.9)	(15.4)	(33.9)
Return/Profitability Ratios (%)					
Recurring Net Income Margins	3.3	5.0	4.7	5.3	6.1
RoCE	14.5	26.3	27.7	27.6	28.7
RoNW	17.6	25.0	27.1	26.9	30.0
Dividend Payout Ratio	13.6	-	15.1	15.1	15.1
Dividend Yield	0.1	-	0.3	0.4	0.6
EBITDA Margins	6.2	8.0	7.2	7.7	8.3

Source: I-Sec research

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