Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

APL Apollo Tubes Limited

Structurally well placed to further gain market share

Building Materials	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. 791**	
Price Target: **Rs. 915**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 9,864 cr
52-week high/low:	Rs. 798/205
NSE volume: (No of shares)	0.9 lakh
BSE code:	533758
NSE code:	APLAPOLLO
Free float: (No of shares)	7.5 cr

Shareholding (%)

Promoters	39.5
FII	0.0
DII	13.5
Others	47.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	18	44	145	138
Relative to Sensex	12	24	105	125

Sharekhan Research, Bloomberg

Summary

- APL Apollo Tubes Limited (APL) is well placed to further gain market share (50% in H1FY2021) led by strong volume growth outlook for its subsidiary, Apollo Tricoat, pick-up in construction activities, and new product launches (recently launched Apollo Mechanical).
- We do not see any material impact on margin from recent steel price hikes as APL's business model is that of converter and the increase in steel price is a pass through to customers. Management has guided for margin expansion to Rs. 4,000/tonne (from Rs. 3,500/tonne in Q2FY21) and further to Rs. 5,000/tonne in the next 2-3 years.
- Consistent volume growth of 15% annually, potential margin expansion (target to increase VAP share to 50% by Q4FY21, 65% in FY22E, and 70-75% in FY23E), RoE of 23-25%, and target to become debt free in FY2021 would re-rate APL.
- We maintain our Buy rating on APL with a revised PT of Rs. 915 (rollover of valuation multiple to FY2023E EPS and factoring in the stock split). At the CMP, the stock is trading at 24.5x its FY2022E EPS and 19x its FY2023E EPS.

APL Apollo Tubes Limited (APL) has transformed itself into a specialty pipes manufacturer from a simple commodity product company and the same is reflected in its strong track-record of sustained market share gain with current share at 50% (an increase of 10 percentage point from FY2020 level of 40%). We expect APL to further gain market share, led by expectation of strong volume growth for its subsidiary Apollo Tricoat in H2FY2021, new product launches (recently launched Apollo Mechanical, which is a Low Diameter High Thickness Steel Tube) and pick-up in the construction activities. Additionally, India's structural steel tube market itself would witness strong growth (10% CAGR over FY2021E-FY2024E) with rising application of the products in real estate, construction, and infrastructure (including affordable housing projects) sectors. The company's business model is that of converter and, thus, the increase in steel prices is a pass through to customers with a time lag. Hence, we do not expect any material impact on margin of APL, given the recent sharp surge in domestic steel prices. In fact, management has guided to expand its margin to Rs. 4,000/tonne (from Rs. 3,500/ tonne in Q2FY2021) and further to Rs. 5,000/tonne in the next 2-3 years, led by focus to increase share of value-added products (VAP) to 50% by Q4FY2021, 65% in FY2022E, & 70-75% in FY2023E, operating leverage (utilisation expected to increase to 88% by FY2023E versus 64% in FY2020) and cost rationalisation (reduction in freight cost and consolidation of manufacturing units). Thus, better-than-expected EBITDA margin could lead to upgrade in FY2022-FY2023 consensus earnings estimates for APL. We believe consistent volume growth outlook of 15% annually, potential margin expansion, RoE of 23%-25%, and strong balance sheet (targets to become debt free in FY2021) warrant premium valuation for APL. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 915 (rollover of valuation multiple to FY2023E EPS and factoring in the stock split). At the CMP, the stock is trading at 24.5x its FY2022E EPS and 19x its FY2023E EPS.

Our Call

Valuation – Maintain Buy on APL with a revised PT of Rs. 915: APL has successfully created a brand name for itself in the niche structural steel tubes space and has superior growth outlook (expect EBITDA/PAT to register 25%/34% CAGR over FY2021E-FY2023E), robust RoE of 23%-25%, and focus to become debt free by FY2021 (ahead of street expectation of FY2022). Moreover, the recent stock split from one equity share of face value of Rs. 10 into five equity shares having a face value of Rs. 2 each would improve the liquidity of shares (5x rise in outstanding equity shares to 12.4 crore). APL's presence in the niche business, first-mover advantage in the structural steel tubes space, and continued product innovation would keep it ahead of industry peers (largely fragmented with unorganised players) and thus we APL to witness valuation re-rating. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 915 (rollover of valuation multiple to FY2023E EPS and factoring in the stock split). At the CMP, the stock is trading at 24.5x its FY2022E EPS and 19x 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	FY19	FY20	FY21E	FY22E	FY23E
Revenue	7,152	7,723	7,819	9,284	11,077
OPM (%)	5.5	6.2	6.9	7.4	7.6
Adjusted PAT	148	256	289	402	517
% YoY growth	-6.3	72.7	13.0	39.0	28.5
Adjusted EPS (Rs.)	12.4	20.6	23.3	32.3	41.5
P/E (x)	63.6	38.4	34.0	24.5	19.0
P/B (x)	10.2	7.3	6.2	5.2	4.3
EV/EBITDA (x)	26.7	22.0	18.3	13.8	11.0
RoNW (%)	16.5	22.1	19.7	23.2	24.7
RoCE (%)	19.5	19.3	18.2	22.4	25.3

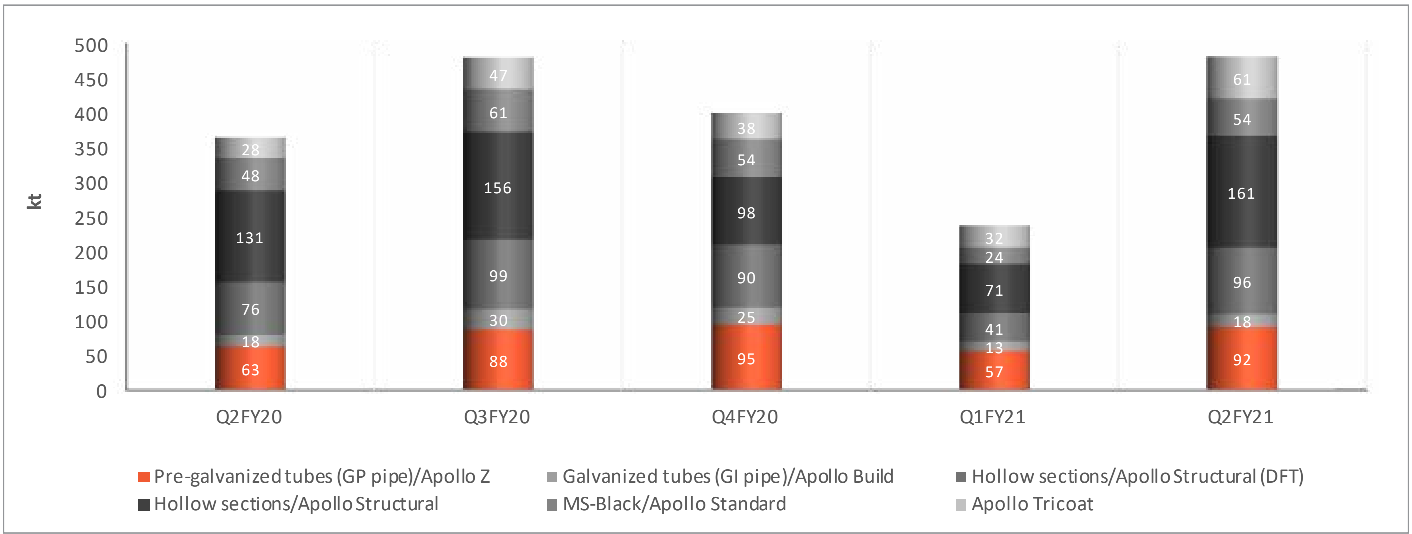
Source: Company; Sharekhan estimates; Note: we have adjusted our EPS to factor in stock split

Rising application and market share gain to lead to sustained double-digit volume growth

APL has strengthened its position in the structured steel tube industry with a sharp increase in its market share to 50% in H1FY2021, which is an increase of 10 percentage points as compared to market share of 40% in FY2020. Market share gain was on account of increasing presence in the rural market (rural sales mix at 55% versus 40% earlier), focus on branding, and shorter product turnaround time. Majority of the market share gain has been from smaller unorganised players.

We expect the momentum to continue as the company is expected to further ramp volumes from its subsidiary Apollo Tricoat. We expect Apollo Tricoat's sales volume to witness 1.6x y-o-y jump to 185ktpa in FY2021 and further 16% y-o-y growth to 215ktpa in FY2022E and 9% y-o-y growth to 234ktpa in FY2023E.

Apollo Tricoat has seen sharp improvement in volumes



Source: Company; Sharekhan Research

Structural steel tubes market is also expected to grow strongly

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 demand to increase significantly over 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. We believe APL is well placed to grab this massive volume opportunity given its presence across India, spare capacity, and market leadership with 50% market share in the structured steel tubes market.

Structured steel tube applications

Conventional Construction Products	Applications	Why Structural Steel Tube replaces these products?
Steel Angle/Channels	Structural support, Towers infrastructure	Uniform Strength, Lower steel consumption
Wood	Furniture, Door Frames, Planks	Cost Effective, Termite Proof, Environmental Friendly
Aluminum Profiles	Facades & Glazing	Cost Effective, Higher Strength
Reinforced Cement Concrete	Construction of Buildings	Faster Construction Environmental Friendly
Fabricated Metal Sheet	Pre-Engineered Steel Buildings	Lower steel consumption Reduces overall project cost

How to replace the conventional products ??

Low Diameter Steel Tubes/Low Load Bearing

High Diameter Steel Tubes/High Load Bearing

Source: Company; Sharekhan Research

New opportunities from the construction industry

Source: Company; Sharekhan Research

Strong volume growth outlook led by rising applications in construction and infrastructure sector

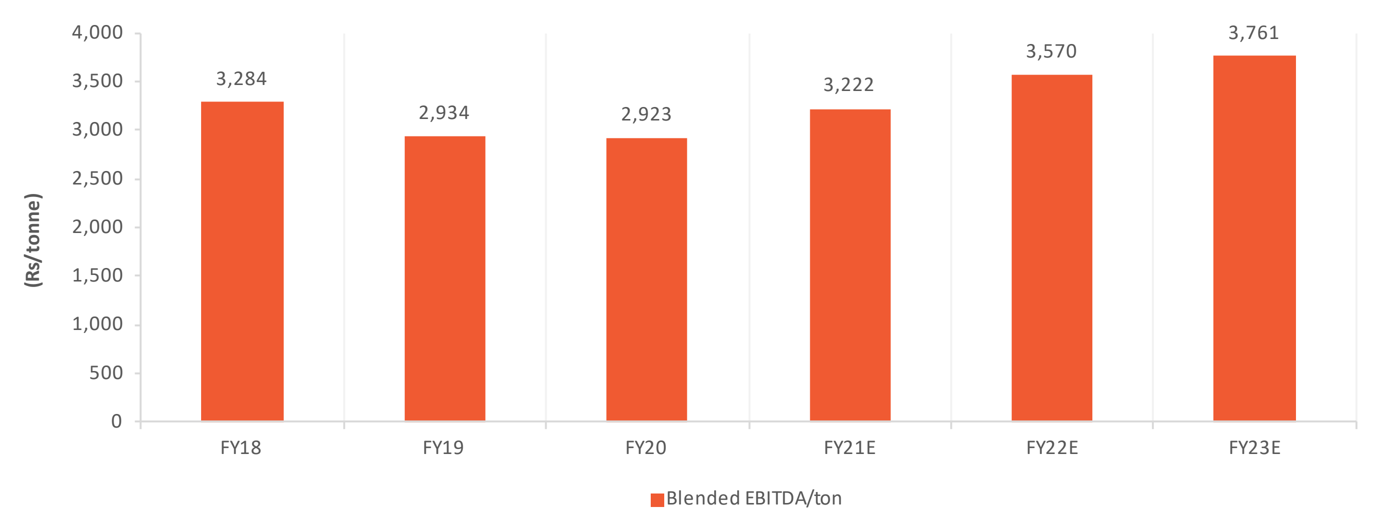
KTPA	FY20	FY21E	FY22E	FY23E	CAGR FY21E-FY23E
Pre-galvanised tubes (GP pipe)/Apollo Z	335	330	380	500	23.1%
Galvanised tubes (GI pipe)/Apollo Build	99	75	120	150	41.4%
Hollow sections/Apollo Structural (DFT)	357	340	410	475	18.2%
Hollow sections/Apollo Structural	513	540	560	580	3.6%
MS-Black/Apollo Standard	216	200	240	290	20.4%
Apollo Tricoat	113	185	215	235	12.7%
Total sales volume	1633	1670	1925	2230	15.6%
Capacity utilisation rate	**64.0%**	**65.5%**	**75.5%**	**87.5%**	

Source: Company; Sharekhan estimates

Margin poised for structural uptrend as APL is focused to increase share of VAP

APL's major raw material is steel (HR coil or strips), but the company is a convertor and thus any movement in steel price is passed on to customers although with time lag. Thus, the recent sharp increase in steel price is not expected to have any material impact on the company's margins. In fact, APL's management has guided to expand EBITDA/tonne to Rs. 4,000 in the near term (from ~Rs. 3,500/tonne currently) and further increase it to Rs. 5,000/tonne over the next couple of years. Margin expansion is likely to be driven by rise in share of high-margin products (such as Apollo Tricoat), and focus on branding, which would yield higher realisation and cost-reduction initiatives (consolidation of manufacturing units and lower freight and employee cost on per tonne basis). Management is targeting to increase share of value-added products to 50% by the end of FY2021E (from 45% currently) and to 65% in FY2022E and 70-75% in FY2023E. Thus, management expects 40%-50% annual volume growth for value-added products over 2-3 years. In-line with this strategy, the company is expected to launch new products such as color pipe tubes and plans to penetrate higher into the building material market (size of 10 million tonne, but penetration remains very low currently). The company would require capex of Rs. 200 crore-250 crore for expanding its portfolio of value-added products. Thus, better-than-expected expansion in EBITDA margin could lead to upgrade in consensus earnings estimates for APL.

Margins to improve with rise in share of VAP



Source: Company; Sharekhan estimates

Product-wise volume break-up

KTPA	FY20	FY21E	FY22E	FY23E
Pre-galvanised tubes (GP pipe)/Apollo Z	335	330	380	500
Galvanised tubes (GI pipe)/Apollo Build	99	75	120	150
Hollow sections/Apollo Structural (DFT)	357	340	410	475
Hollow sections/Apollo Structural	513	540	560	580
MS-Black/Apollo Standard	216	200	240	290
Apollo Tricoat	113	185	215	235
Total sales volume	**1,633**	**1,670**	**1,925**	**2,230**

Source: Company; Sharekhan estimates

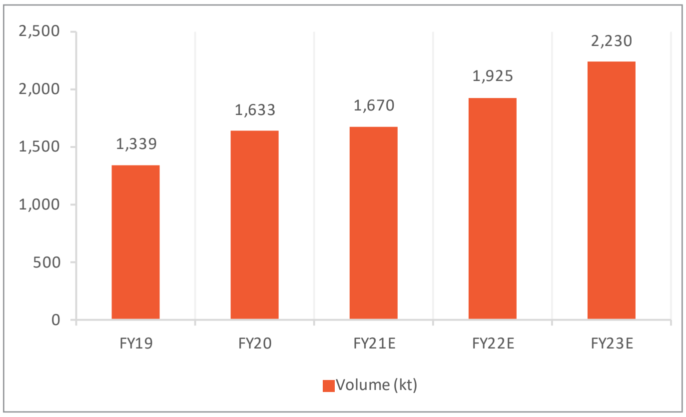
Product wise EBITDA/tonne

EBITDA (Rs./tonne)	FY20	FY21E	FY22E	FY23E
Pre-galvanised tubes (GP pipe)/Apollo Z	5,254	5,600	5,850	6,000
Galvanised tubes (GI pipe)/Apollo Build	4,152	4,750	4,850	4,950
Hollow sections/Apollo Structural (DFT)	2,667	2,350	3,050	3,150
Hollow sections/Apollo Structural	1,817	1,900	2,050	2,150
MS-Black/Apollo Standard	1,259	1,250	1,400	1,450
Apollo Tricoat	5,912	5,950	6,200	6,300
Blended EBITDA	**2,923**	**3,222**	**3,570**	**3,761**

Source: Company; Sharekhan estimates

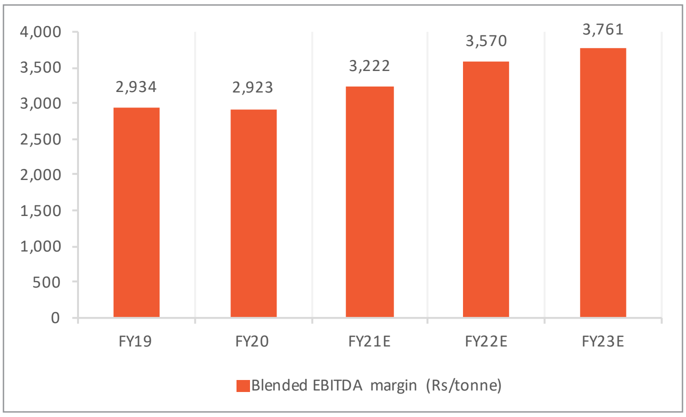
Financials in charts

Volume to post an 16% CAGR over FY2021E-FY2023E



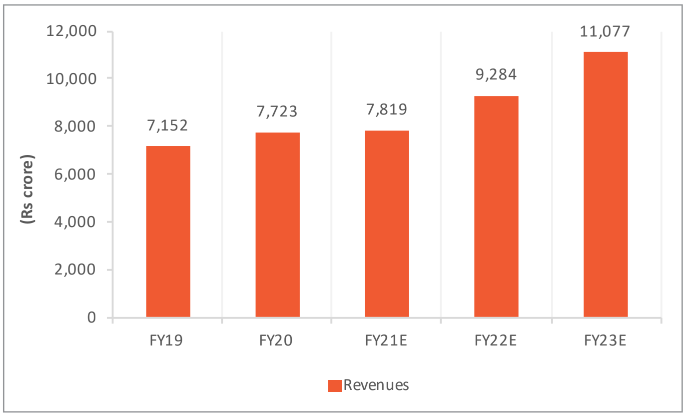
Source: Company, Sharekhan Research

Margin expansion given rise in share of high-margin products



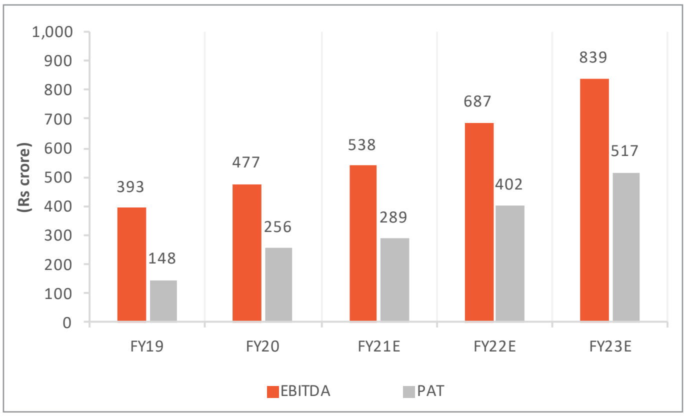
Source: Company, Sharekhan Research

Revenue trend



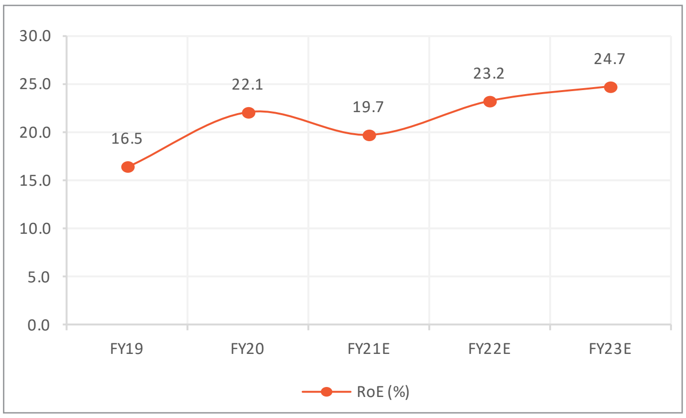
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 25%/34% over FY2021E-FY2023E



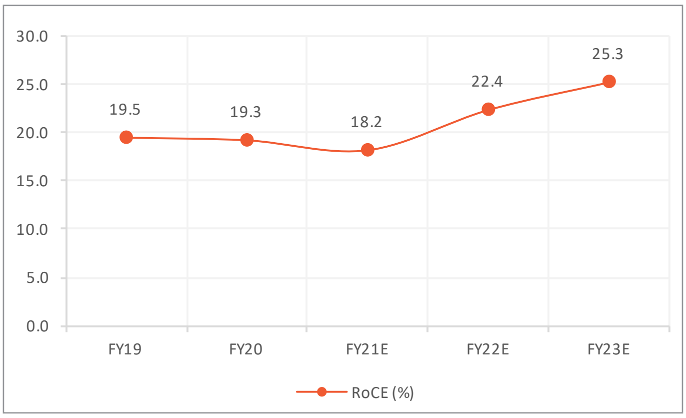
Source: Company, Sharekhan Research

Robust RoE track record



Source: Company, Sharekhan Research

Robust 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 demand to increase significantly over 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.

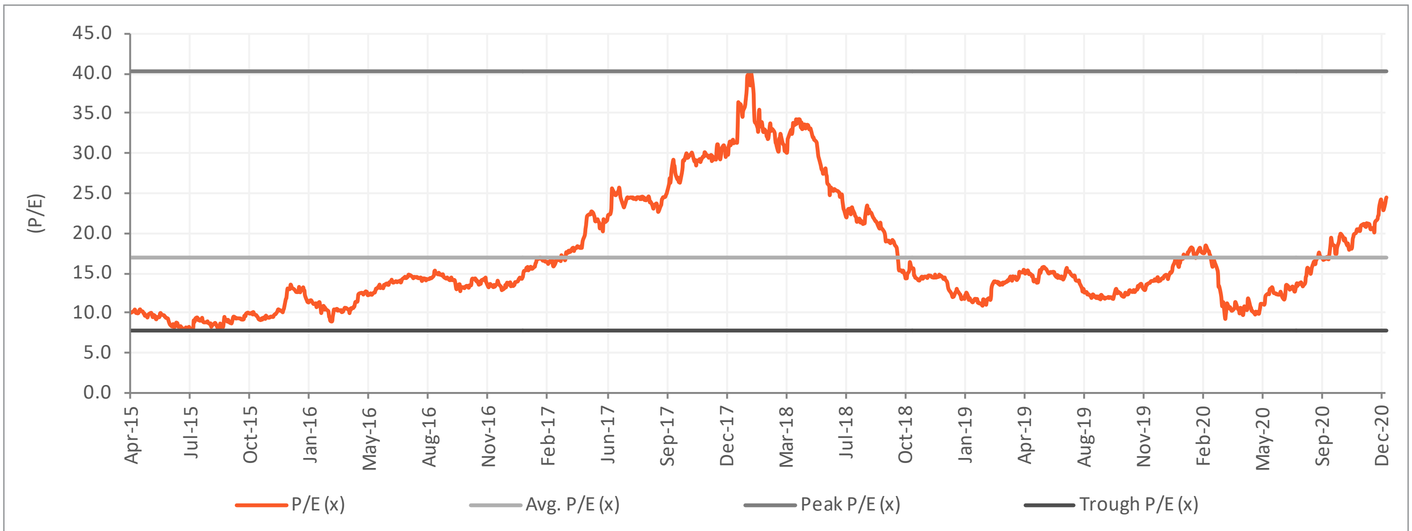
■ Company Outlook – Sustainable earnings growth led by structural volume growth drivers and potential margin expansion

APL's volume has posted a 21% CAGR over FY2017-FY2020, led by market share gain 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 16% volume CAGR over FY2021E-FY2023E and reach 2.2 million tonne by FY2023E. Moreover, premiumisation and cost reduction would expand EBITDA margin by 29% to Rs. 3,761/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. 915

APL has successfully created a brand name for itself in the niche structural steel tubes space and has superior growth outlook (expect EBITDA/PAT to register 25%/34% CAGR over FY2021E-FY2023E), robust RoE of 23%-25%, and focus to become debt free by FY2021 (ahead of street expectation of FY2022). Moreover, the recent stock split from one equity share of face value of Rs. 10 into five equity shares having a face value of Rs. 2 each would improve the liquidity of shares (5x rise in outstanding equity shares to 12.4 crore). APL's presence in the niche business, first-mover advantage in the structural steel tubes space, and continued product innovation would keep it ahead of industry peers (largely fragmented with unorganised players) and thus we APL to witness valuation re-rating. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 915 (rollover of valuation multiple to FY2023E EPS and factoring in the stock split). At the CMP, the stock is trading at 24.5x its FY2022E EPS and 19x 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	PIIN KITARA	12.0
2	KITARA PIIN 1101	8.7
3	Kotak Mahindra Asset Management Co	3.1
4	GUPTA VEERA	2.4
5	SAMPAT SAMEER MAHENDRA	2.3
6	DSP Investment Managers Pvt Ltd	2.2
7	Vanguard Group Inc/The	2.0
8	Goldman Sachs Group Inc/The	1.7
9	ICICI Prudential Life Insurance Co	1.6
10	IDFC Mutual Fund/India	1.3

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

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;