



APL Apollo Tubes Limited

Consistent outperformer; Q3 margin at record level

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. 942	
Price Target: Rs. 1,180	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

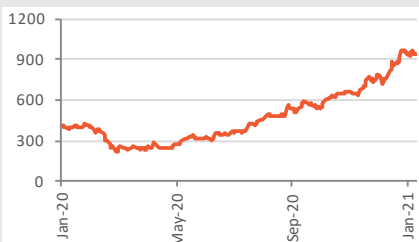
Company details

Market cap:	Rs. 11,755 cr
52-week high/low:	Rs. 990 / 205
NSE volume: (No of shares)	1.6 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	150	128
Relative to Sensex	14	34	123	110

Sharekhan Research, Bloomberg

Summary

- Q3FY21 was stellar, with a sharp 28% beat in operating profit at Rs. 232 crore (up 45% y-o-y) on account of best-ever EBITDA margin of Rs. 4,780/tonne (up 16% y-o-y) and in-line volumes of 486kt (up 1% y-o-y).
- Upbeat volume growth guidance of 16/20% y-o-y for FY2021E/FY2022E and high EBITDA of Rs. 4,000-4,500/tonne (vs. historical average of Rs. 3,000-3,500/tonne) to sustain led by improvement in share of VAP (at 60% Q3FY21). Target to take capacity to 4mtpa by FY2025 and capex plan of Rs. 200 crore pa to expand VAP portfolio.
- Consistent volume growth of 15-20% per annum, potential margin expansion (rising share of VAP) and scalability given low share of structured steel in India's steel consumption would further aid re-rating of APL.
- We maintain a Buy rating on APL with a revised PT of Rs. 1,180 given sustainable high double-digit earnings growth (expect 37% PAT CAGR over FY21E-FY23E) and high RoE of 28%. At CMP, the stock trades at 18.4x FY23E EPS.

APL Apollo Tubes Limited (APL) reported strong Q3FY2021 results with a sharp 28% beat in operating profit at Rs. 232 crore (up 44.6% y-o-y; up 37.3% q-o-q) versus our estimate of Rs. 181 crore. Operating profit exceeded estimates driven by higher-than-expected EBITDA margin of Rs. 4,780/tonne (up 43% y-o-y; up 36% q-o-q and versus our estimate of Rs. 3,737/tonne) on account of rise in gross margin to Rs. 8,523/ton (up 16.1% y-o-y; up 15.7% q-o-q) and cost control (opex down by 6.4% y-o-y on a per tonne basis). We highlight here that 91% of incremental EBITDA margin on q-o-q basis was led by value-added products. Gross margin expansion is attributable to increase in the share of high-margin products to 60% in Q3FY2021 while operating cost declined due to rationalisation of freight cost and selling & administrative expenses. Sales volumes increased by only 1.1% y-o-y (up 0.9% q-o-q) to 486 kt (in line with estimates) due to constraint with regards to raw material supply. PAT (after minority interest) at Rs. 132 crore (up 77.8% y-o-y; up 43.3% q-o-q) was also 32% above our estimate of Rs. 100 crore, led by better-than-expected profitability. The management has guided for a 20% volume growth in FY2022 and expects margin to sustain at Rs. 4,000-4,500/tonne. With respect to long term outlook, management is targeting to expand its capacity to 4mtpa (from 2.6mtpa currently) and expect margin to further improve (from near term target of Rs. 5,000/tonne) as share of VAP (launch of high-margin products like color pipe tubes and full ramp-up at Apollo Tricoat) is likely increase in coming years. We believe consistent volume growth outlook of 15-20% annually, potential margin expansion, high RoE/RoCE of 28%/31% and a strong balance sheet (net debt/equity of only 0.12x) warrant premium valuation for APL. Additionally, the management is keen to reward shareholders through share buyback/dividend and would formalise its dividend policy post Q4FY2021. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,180 (reflects upward revision in earnings estimate). At the CMP, the stock is trading at 23.7x its FY2022E EPS and 18.4x its FY2023E EPS.

Key positives

- Better-than-expected EBITDA margin at Rs. 4,780/tonne (up 43% y-o-y) led by higher gross margin and lower operating cost.
- Sharp 34%/33% reduction in gross debt/net debt at Rs. 529 crore/Rs. 198 crore with net debt/equity at only 0.12x as of December 2020.

Key negatives

- Volume growth of only 1% y-o-y to 486kt due to constraint on raw material supply.

Our Call

Valuation – Maintain Buy on APL with a revised PT of Rs. 1,180: We have increased our FY2021-FY2023 earnings estimate by 17-23% to factor in higher margins as large part Q3FY2021 margin expansion to Rs. 4,780/tonne (versus historical average of Rs. 3,000-3,500/tonne) seems sustainable given expectation of improvement in product mix. 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 a 29%/37% CAGR over FY2021E-FY2023E) along with robust RoE/RoCE of 28%/31%. 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 expect APL to witness further valuation re-rating. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,180 (reflects upward revision in earnings). At CMP, the stock is trading at 23.7x its FY2022E EPS and 18.4x its FY2023E EPS.

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 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)	75.8	45.8	34.7	23.7	18.4
P/B (x)	12.1	8.6	7.2	5.7	4.6
EV/EBITDA (x)	31.5	26.0	17.9	12.7	9.8
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

Sharp beat in EBITDA margin led to higher-than-expected PAT

Q3FY2021 results were strong, with a robust 22.9% y-o-y and 18.1% q-o-q increase in revenue to Rs. 2,601 crore (9.3% above our estimate of Rs2,379 crore), primarily led by better realisation (up 21.6% y-o-y; up 17% q-o-q) and marginal 1% y-o-y (up 0.9% q-o-q) increase in sales volumes to 486 kt. The volume growth was constrained due lower availability of raw material. EBITDA margin improved by 43% y-o-y and 36% q-o-q to Rs. 4,780/tonne, much higher than our expectation of Rs. 3,737/tonne on account of a rise in gross margin at Rs. 8,523/tonnes (up 16.1% y-o-y; up 15.7% q-o-q) and cost control (opex down by 6.4% y-o-y on per ton basis). Consequently, operating profit grew by 44.6% y-o-y (up 37.3% q-o-q) to Rs. 232 crore (above our estimate of Rs. 181 crore). PAT (after minority interest) at Rs. 132 crore (up 77.8% y-o-y; up 43.3% q-o-q) was also 32% above our estimate of Rs. 100 crore, led by better-than-expected profitability.

Q3FY2021 conference call highlights

- ♦ **Volume and margin outlook** – The management is confident of a 15-16% volume growth in FY2021 and has guided for 20% y-o-y volume increase for FY2022. In terms of margins, a large part of the recent expansion is sustainable and has guided for EBITDA margin to be in the range of Rs4,000-4,500/tonne with target to expand it further to Rs. 5,000/tonne in near term. High margins are sustainable given further cost rationalization from lower power, freight and stores cost.
- ♦ **Long-term business outlook** – The company has guided to expand its overall capacity to 4mtpa by 2025, which is 57% increase from current capacity of 2.55 mtpa. The management indicated it would pursue both organic and inorganic growth strategy for its capacity expansion plan. 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% in coming quarters) and expects gross margins to further increase to Rs. 10,000/ton from Rs. 8,523/ton in Q3FY2021. There is no plan to expand capacity at Apollo Tricoat and focus is to improve utilisation further from 83% in Q3FY2021 and expand margins. New product launches of color pipe tubes and 500 square new lines (for multi-storey buildings) would create market for the new product.
- ♦ **Capex plan** – The management aims to spend ~25% of EBITDA for capex and guided for capex of Rs200 crore annually over next few years. The majority of capex would be spent on expansion of the company's value-added product portfolio. The company is adding 4 lakh ton capacity to its Raipur plant and the expansion is expected to be completed over FY2021-FY2022.
- ♦ **Cash utilization strategy** – The management is keen to reward its shareholders through share buyback or dividend post repayment of debt and capex for value-added products. The company would formalise its dividend policy after Q4FY2021.
- ♦ **Focus to further improve working capital cycle** – The company reduced net working capital to 8 days in 9MFY2021 as compared to 10 days in Q1FY2021 and 25 days in FY2020. Ultimately, the company targets to turn its working capital cycle to negative. Gross debt/net debt declined by 34%/33% to Rs. 529 crore/Rs. 198 crore with net debt/equity at only 0.12x led by robust FCF generation of Rs. 664 crore (up 18% q-o-q).
- ♦ The management has indicated that the company added 15 new distributors in Q3FY2021 especially in tier-1 and tier-2 cities. Also there is keen focus to expand distribution network in rural areas.
- ♦ The company maintains inventory level only 15-17 days and thus do not expect any material impact from movement in steel prices (which is largely pass through to customers).

Results

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Net Sales	2,601	2,116	22.9	2,202	18.1
Total Expenditure	2,369	1,955	21.1	2,033	16.5
Reported operating profit	232	161	44.6	169	37.3
Adjusted operating profit	232	161	44.6	169	37.3
Other Income	8	5	78.2	10	-17.3
Interest	15	28	-47.6	16	-7.5
Depreciation	26	26	0.0	25	4.6
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	200	111	79.9	138	44.4
Adjusted PBT	200	111	79.9	138	44.4
Tax	51	28	83.4	36	42.6
PAT before MI	149	83	78.7	103	45.0
Minority Interest	17	9	86.2	11	59.3
PAT After MI	132	74	77.8	92	43.3
Adjusted PAT after MI	132	74	77.8	92	43.3
Equity Cap (cr)	12.5	12.5		12.5	
Reported EPS (Rs)	10.6	6.0	77.8	7.4	43.3
Adjusted EPS	10.6	6.0	77.8	7.4	43.3
Margins (%)			BPS		BPS
OPM	8.9	7.6	134	7.7	125
Effective tax rate	25.4	24.9	49	25.7	-31
NPM	5.1	3.5	157	4.2	89

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Volume (kt)	486	480	1.1%	481	0.9%
Realisation (Rs/ton)	53,563	44,060	21.6%	45,770	17.0%
Gross margin (Rs/ton)	8,523	7,341	16.1%	7,365	15.7%
EBITDA margin (Rs/ton)	4,780	3,342	43.0%	3,514	36.0%

Source: Company; Sharekhan Research

Product-wise volume break-up

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

Source: Company; Sharekhan Research

Product wise EBITDA margin

Particulars	Q1FY21	Q2FY22	Q3FY21
Apollo Structural			
Heavy Structures	3,900	4,200	5,000
Light Structures	3,600	4,000	5,100
General Structures	1,143	1,382	1,993
Apollo Z			
Rust-proof structures	5,300	6,236	7,654
Rust-proof sheet	4,556	456	4,760
Apollo Tricoat	5,795	6,133	782
Apollo Galv	3,491	5,655	6,950
Blended margins (Rs/ton)	2,979	3,514	4,780

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 tonnes 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 tonnes by FY2024E.

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

APL's volumes clocked 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/tonnes 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. 1,180:

We have increased our FY2021-FY2023 earnings estimate by 17-23% to factor in higher margins as large part Q3FY2021 margin expansion to Rs. 4,780/tonne (versus historical average of Rs. 3,000-3,500/tonne) seems sustainable given expectation of improvement in product mix. 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 a 29%/37% CAGR over FY2021E-FY2023E) along with robust RoE/RoCE of 28%/31%. 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 expect APL to witness further valuation re-rating. Hence, we maintain our Buy rating on APL with a revised PT of Rs. 1,180 (reflects upward revision in earnings). At CMP, the stock is trading at 23.7x its FY2022E EPS and 18.4x 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.

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	8.7
2	KITARA PIIN 1101	3.4
3	SAMPAT SAMEER MAHENDRA	2.3
4	Vanguard Group Inc/The	2.3
5	Kotak Mahindra Asset Management Co	2.2
6	DSP Investment Managers Pvt Ltd	2.1
7	ICICI Prudential Life Insurance Co	1.7
8	Goldman Sachs Group Inc/The	1.7
9	Taiyo Greater India Fund	1.6
10	Mobius Inv Trust Plc	1.3

Source: Bloomberg

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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 deteriorating 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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