Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

APL Apollo Tubes Ltd

Strategic move to widen distribution reach

Building Material	Sharekhan code: APLAPOLLO		
Reco/View: Buy ↔	CMP: Rs. 938	Price Target: Rs. 1,100 ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

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 Feb 08, 2022

Severe Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 23,464 cr
52-week high/low:	Rs. 1,114/585
NSE volume: (No of shares)	16.4 lakh
BSE code:	533758
NSE code:	APLAPOLLO
Free float: (No of shares)	16.4 cr

Shareholding (%)

Promoters	34.5
FII	24.6
DII	10.7
Others	30.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	13	-9	2	42
Relative to Sensex	12	-10	6	26

Sharekhan Research, Bloomberg

Summary

- APL Apollo Tubes (APL) announced investment of Rs. 181 crore in its key distributor Shankara Building Products, through its wholly-owned subsidiary APL Apollo Mart. The investment would be made through a combination of secondary market purchase (10 lakh shares at Rs. 755/share) and proposed preferential warrants (14 lakh warrants at Rs. 750/share).
- Investment rationale – Through this investment, APL aims to improve sales/volumes by leveraging Shankara's store network and further strengthening its long relationship with the distributor. The deal is valued at 0.9x EV/Sales (FY22 annualised).
- APL's management expects the investment to be EPS/RoCE accretive in first year but we await more clarity on plans to achieve the same. Investment to provide sales consistency from Shankara and could aid volume/utilisation at its Hyderabad plant (we estimate current EBITDA contribution of Rs. 50 crore).
- We maintain a Buy rating on APL with an unchanged PT to Rs. 1,100 as structural earnings growth drivers and likely improvement in earnings quality would narrow valuation gap with building material players like Astral.

APL Apollo Tubes Limited (APL) has announced to invest Rs. 180.5 crore for a 9.9% equity stake in Shankara Building Products (Shankara) through its wholly-owned subsidiary APL Apollo Mart. Shankara is already a key distributor of APL and the investment would help APL further leverage Shankara's distribution reach (presence across 10 states with 90 stores covering 450,000 sq. ft and 30,000 SKUs across the home construction and renovation lifecycle) and provide cross-selling opportunities for APL. As per our analysis, APL's 0.2 million-tonne Hyderabad plant (acquired from Shankara in April 2019 with high-margin products such as GI/GP pipes) contributes EBITDA of Rs50 crore assuming 50% utilisation and margin of Rs. 5,000/tonne. The deal would help to push more products through Shankara's stores and could improve utilisation for APL's Hyderabad plant going forward. The management expects investment to drive margin/earnings and to be EPS/RoCE accretive form the first year onwards but await further clarity on management's plan to achieve the same.

- **APL announces minority equity investment in Shankara Building Products:** APL through its wholly owned subsidiary APL Apollo Mart Limited has announced to invest Rs. 180.5 crore for minority equity stake of 9.9% (on fully diluted basis) in Shankara Building Products. The investment would be done through a secondary market purchase (10 lakh shares at Rs. 755/share) and proposed preferential convertible warrants (14 lakh warrants at Rs750/warrant, which is yet to be approval by Shankara's board of directors). The investment would be made in two tranches with an immediate investment of Rs 101.8 crore (secondary market purchase of 10 lakh shares at Rs. 755/share and 25% warrant subscription money) and Rs. 78.7 crore (75% on warrant conversion) within the next 18 months. The investment deal is expected to get completed in Q1FY23 subject to necessary regulatory approvals and valued at 0.9x EV/sales (FY22 annualised revenue of Shankara). APL would fund investment from internal accruals.
- **Investment rationale:** The management indicated the following rationales for investment in Shankara: 1) The investment is aligned to APL's growth plan for the next three years, 2) launch platform for APL's new products, 3) synergies through Shankara's retail/wholesale network, 4) association would ensure sales consistency as Shankara is APL's key distributor and 5) expansion of structural steel tubes market.
- **Our View:** We highlight here that APL had acquired Shankara's manufacturing unit in Hyderabad in April 2019 for Rs. 70 crore and recovered its investment within three years. The plant has a production capacity of 0.2 mn tonnes of GI/GP pipes (high margin value added products) and become operational in Q2FY20. We believe that the new investment would further strengthen relationship with Shankara (15 years of association and a key distributor of APL's products) and help boost volume from Shankara's store network and likely improve utilisation of its Hyderabad plant. The management expects investment to drive margin/earnings and to be EPS/RoCE accretive but await more clarity on management's plan to achieve the same.

Our Call

Valuation – Maintain Buy on APL with an unchanged 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 25.5x FY2024E EPS as compared to valuation of 46x for players like Astral Limited). We expect APL to sustain its high earnings growth momentum (expect PAT CAGR of 37% over FY21-24E) supported by robust double-digit volume growth and margin expansion. Hence, we maintain a Buy rating on APL with an unchanged PT of Rs. 1,100.

Key Risks

A delayed recovery in demand from construction and infrastructure projects could hurt earnings outlook. Any intensifying of competition from well-established steel companies could affect APL's 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)	65.1	41.9	32.3	25.5
P/B (x)	13.8	10.9	8.5	6.7
EV/EBITDA (x)	34.7	24.2	18.8	14.7
RoNW (%)	23.6	29.1	29.6	29.4
RoCE (%)	25.4	32.9	35.2	36.4

Source: Company; Sharekhan estimates

Breaking down APL's investment – Deal valued at 0.9x EV/Sales (FY22 annualised)

APL Apollo Mart Ltd (A wholly owned subsidiary of **APL Apollo Tubes Ltd**) to buy minority equity stake in **Shankara Building Products Ltd**

- 1,000,000 shares from Promoters @ Rs755 per share
- 1,400,000 preferential convertible warrants @ Rs750 per warrant *
- Total holding after issue of the warrants will be 9.90% on fully diluted basis

- Total investment outlay: Rs 1,805mn
  - Immediate: Rs 1,018mn (Secondary purchase+25% warrant subscription money)
  - Within 18 months: Rs 787mn (75% on warrant conversion)
- Investment to be funded from internal cash flows
- Shankara amongst APL Apollo's key distributors
- Total investment accounts for 6% of APL Apollo's total capital employed*
- EPS and ROCE accretive from first year onwards

Source: Company

Investment rationale

- Investment aligned with APL Apollo's growth plan
- Existing Business association for last 15 years
- Shankara amongst APL Apollo's key distributors
- Association to ensure sales consistency
- Launch platform for APL Apollo's new products
- Synergies through Shankara's Retail/Wholesale network
- Expansion of structural steel tubes market

Source: Company

About Shankara Building Products

- **Shankara Building Products:** One of India's leading organized retailer/wholesaler of home improvement and building products
- Revenue of Rs22bn (annualized FY22) with Steel tubes/products forming majority of sales
- Presence in 10 states with cumulative store base of 90 covering 450,000 sq. ft.
- Sells over 30,000+ SKUs across the entire home construction and renovation lifecycle

Source: Company

APL's past experience with Shankara

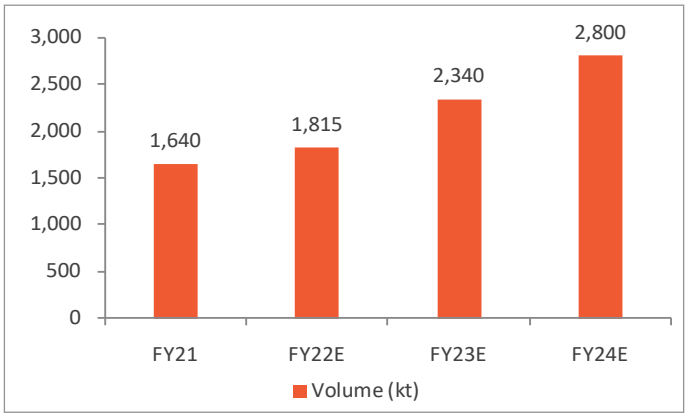
- APL Apollo acquired Shankara's 200k ton Hyderabad plant for Rs 700mn in April 2019
- APL Apollo recovered its investment cost within 3 years boosting overall ROCE
  - *Plant contribution in expansion of Southern India sales*
  - *Sales boost from MoU*
- Plant continues to contribute towards APL Apollo's growth

SHANKARA Buildpro Building Materials and more

Source: Company

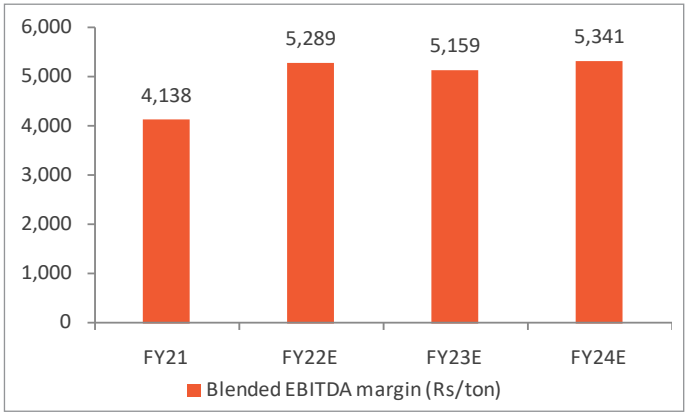
Financials in charts

Volume to post a 20% CAGR over FY2021-FY2024E



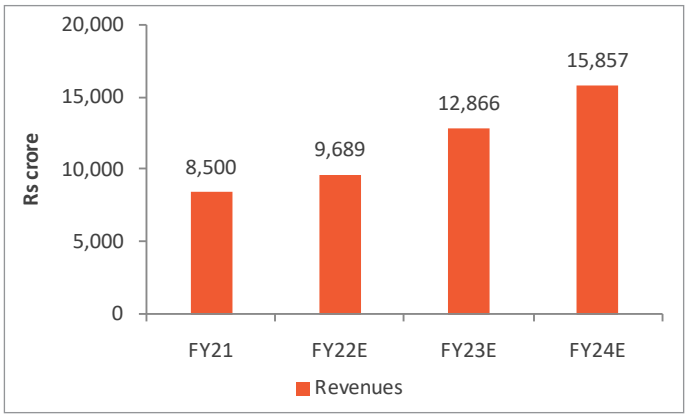
Source: Company, Sharekhan Research

Margin expansion given rise in share of high-margin products



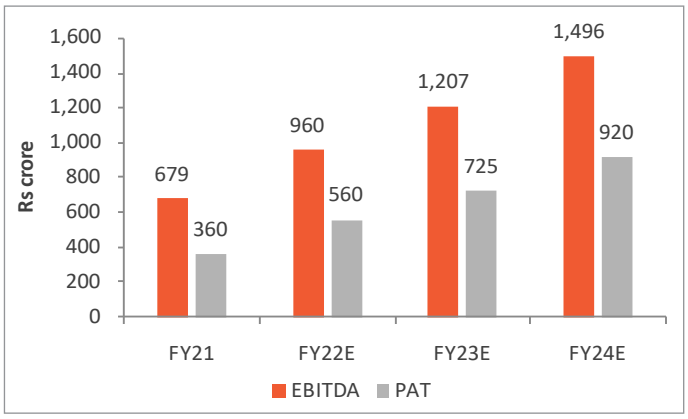
Source: Company, Sharekhan Research

Revenue trend



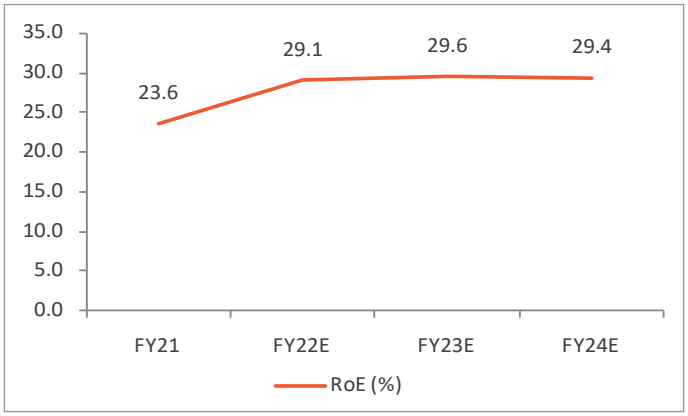
Source: Company, Sharekhan Research

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



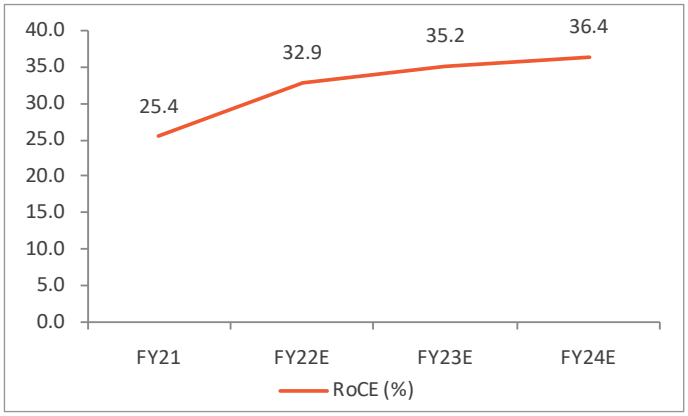
Source: Company, Sharekhan Research

Robust RoE track record



Source: Company, Sharekhan Research

RoCE improving consistently



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Structural steel tubes market to clock 17% CAGR over 2019-2030E, led by higher demand from construction projects

The structural steel tubes market 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.

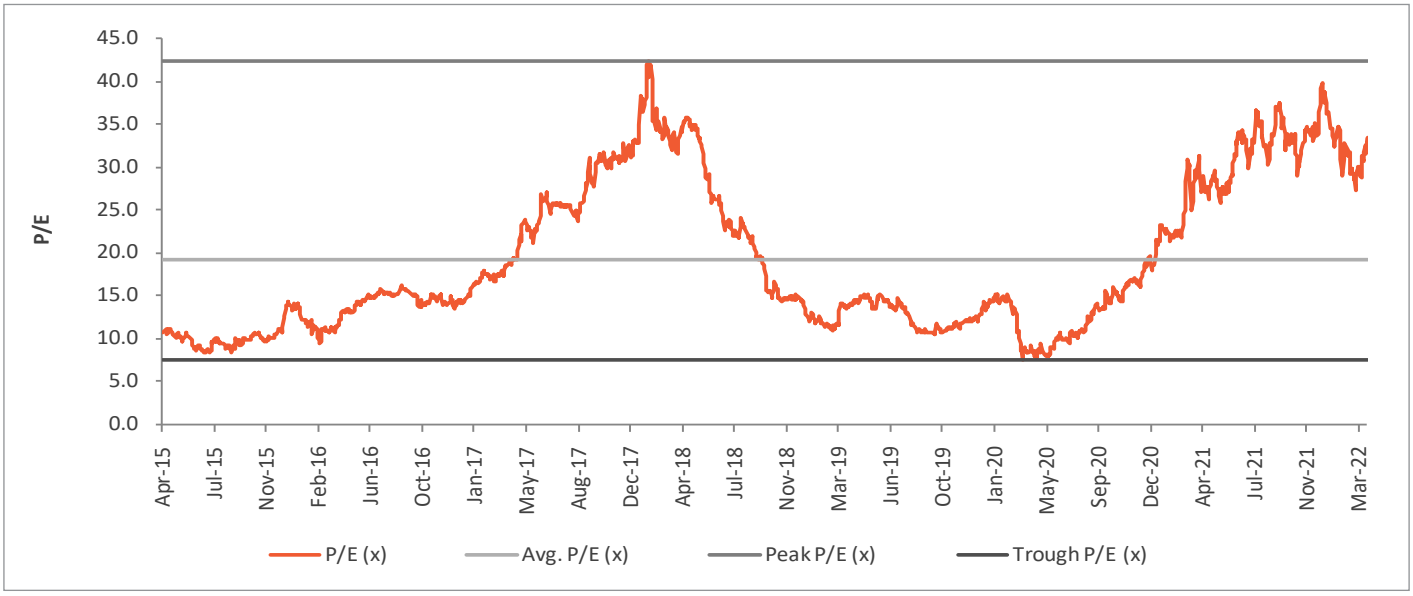
■ Company outlook - Earnings growth to sustain led by structural volume growth drivers and potential margin expansion

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 (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 CAGR over FY21-24E) versus peers in the medium to long term.

■ Valuation - Maintain Buy on APL with an unchanged 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 25.5x FY2024E EPS as compared to valuation of 46x for players like Astral Limited). We expect APL to sustain its high earnings growth momentum (expect PAT CAGR of 37% over FY21-24E) supported by robust double-digit volume growth and margin expansion. Hence, we maintain a Buy rating on APL with an unchanged PT of Rs. 1,100.

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 9-10%. 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	PIIN KITARA	7.6
2	Capital Group Cos Inc.	5.9
3	DSP Investment Managers	2.4
4	Sampat Sameer Mahendra	2.3
5	Vanguard Group Inc.	2.0
6	ICICI Prudential Life Insurance	1.9
7	Kotak Mahindra Asset Management Co. Ltd	1.7
8	FIL Limited	1.1
9	William Blair & Company LLC	0.9
10	L&T Mutual Fund Trustee Ltd	0.9

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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