

APL Apollo Tubes

18 December, 2017

COMPANY UPDATE

Sector: Steel Pipes Rating: Buy

CMP: Rs1,890 Target Price: Rs2,360

Stock Info

Sensex/Nifty	33,601/ 10,388
Bloomberg	APAT IN
Equity shares (mn)	23.4
52-wk High/Low	2,027/ 852
Face value	Rs10
M-Cap	Rs46.4bn/ \$714mn
3-m Avg volume	\$0.78mn

Financial Snapshot (Rs mn)

Y/E Mar	FY18e	FY19e	FY20e
Sales	53,372	63,628	74,488
EBITDA	3,762	4,617	5,640
PAT	1,609	2,154	2,818
EPS (Rs)	68.7	91.9	120.2
PE (x)	31.6	23.6	17.9
EV/EBITDA (x)	13.5	11.0	8.9
P/B (x)	5.4	4.5	3.7
RoE (%)	19.1	21.4	23.1
RoCE (%)	21.9	24.0	26.5

Shareholding pattern (%)

	Sep '17	Jun '17	Mar '17
Promoter	37.5	37.5	37.5
- Pledged	-	-	-
FII	-	-	0.4
DII	14.5	15.2	15.4
Others	48.0	47.3	46.7

Stock Performance (1-year)



Long-term growth prospects intact, maintain Buy

We recently met APL Apollo Tubes' (APAT) management and are reaffirmed with our views on the company's long-term growth prospects and strategic capacity expansion plan. APAT targets to post 25%+ volume growth for the next three years on the back of 1) scheduled capacity expansion (from 1.3mtpa to 2.5mtpa by FY20), 2) shift in capacity to organised players (especially to APAT) led by GST, expressway bill & APAT's aggressive capex plan and 3) increase in revenue from exports market and OEMs (solar industry and PEB), from current 10% to 30% by FY20e, led by the introduction of DFT. Quick ramp-up of recently installed capacity at Raipur (40% capacity utilization) and roll-over of additional DFT line (four to eight lines by FY18) to further improve margins and reduce logistic costs, thereby translating into EBITDA/t of Rs3,514, from Rs3,120/t (in 1HFY18). Post our interaction with the management and noting APAT's robust track record historically, we remain positive on the stock, with a **Buy** rating and a revised target price of Rs2,360.

20% volume CAGR expected during FY18-20e

APAT's capacity and volume clocked a CAGR of 21% and 26% respectively during FY13-17, compared to an industry growth rate of ~9%, thus leading peers like Surya Roshni, Tata Pipes, Rama Steel among others. Management targets to post volumes of ~25%+ CAGR going forward. Currently, APAT holds a domestic market share of ~14%, which management expects to increase to 20%, once the planned capacity expansion comes on stream. Nearly 50% of the market is currently catered by the unorganised segment, and post GST's transition, management expects to increase its market share. Due to timely commissioning of Raipur facility (logistic cost savings), aggressive capacity expansion (24% CAGR over FY17-20e) and installation of DFT lines, we expect APAT's volumes to post 20% CAGR during FY17-20e.

DFT to expand addressable market with better profitability

APAT has commercialised four DFT lines at Hosur and Raipur plants, with plans to install another four lines at Murbad, Secunderabad and Hosur plant by 4QFY18. With the installation of DFT lines, it can cater to many new applications, with an ability to produce different sizes (up to 300*300 dia). With DFT, an entire new export and OEM market has opened to the company, where profitability is higher. Current share from export and OEM is ~10% and is expected to increase to 30% by FY20e. Overall, DFT has expanded the total addressable market with better OPM; EBITDA/t for FY17 was at Rs3,313/t and is expected to increase by 7% to Rs3,514/t by FY20e-end. Until FY20, APAT targets to capture market share by expanding aggressively, post which it will focus on increasing profitability further.

Network expansion and aggressive branding exercise to increase market share from 14% to 20% by FY20e

The government's focus on infrastructure and rapid development of smart cities is expected to aid ERW pipes demand to increase more than 10% for the next four to five years. Being the leader, APAT has distinct advantages of scale, retail network and strong brand. With a network of >600 dealers and strong brand recall, APAT governs 14% market share in Indian ERW pipe industry. Currently, it has 29 warehouses spread across India, which is expected to increase to 100 by FY20e. With an increase in dealer reach, we expect APAT's market share to rise to 20% by FY20e.

Valuation

We estimate APAT's total revenue/PAT to post a CAGR of 21/31% respectively over FY18e-20e, with healthy return ratios and positive FCF. We believe the stock deserves a premium valuation of 10x 1HFY20e EV/EBITDA, and maintain a **Buy** rating with a revised target price of Rs2,360.

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FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY16	FY17	FY18e	FY19e	FY20e
Net revenues	42,136	45,450	53,372	63,628	74,488
Revenue growth (%)	34.3	7.9	17.4	19.2	17.1
- Op. expenses	39,319	42,206	49,610	59,011	68,848
EBIDTA	2,817	3,244	3,762	4,617	5,640
EBITDA margins (%)	6.7	7.1	7.0	7.3	7.6
- Interest expenses	695	683	715	715	715
- Depreciation	341	512	608	772	818
+ Other income	102	38	38	38	38
- Tax	624	627	867	1,013	1,326
Effective tax rate (%)	38.3	30.1	35.0	32.0	32.0
Reported PAT	1,006	1,459	1,609	2,154	2,818
+/- Extraordinary items	(253)	-	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	1,260	1,459	1,609	2,154	2,818
EPS (Rs/share)	43	62	69	92	120
EPS growth	58.0	45.0	10.3	33.8	30.9

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY16	FY17	FY18e	FY19e	FY20e
Share capital	234	236	236	236	236
Reserves & Surplus	5,441	6,967	8,190	9,827	11,969
Networth	5,675	7,203	8,426	10,063	12,205
Total Debt	6,505	5,962	5,962	5,962	5,962
Def. tax liab. (net)	859	905	905	905	905
Capital employed	13,039	14,070	15,293	16,930	19,072
Net Fixed assets	6,553	7,901	8,292	10,320	10,203
Goodwill on consolidation	429	670	670	670	670
Investments	131	127	127	127	127
- of which liquid	-	-	-	-	-
Net Working capital	5,914	5,356	5,886	5,468	7,298
Cash and bank balance	14	17	317	343	771
Capital deployed	13,039	14,070	15,293	16,930	19,071
Net debt	6,491	5,945	5,645	5,619	5,190
WC (days)	51	43	40	31	36
Book value (Rs/sh)	242	307	359	429	521

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY16	FY17	FY18e	FY19e	FY20e
PBT	1,630	2,086	2,476	3,167	4,145
+ Non cash items	1,250	1,254	1,324	1,487	1,533
Cash profit	2,880	3,340	3,799	4,655	5,678
- Incr/(Decr) in WC	-2,335	695	-530	418	-1,830
Operating cash flow	113	3,384	2,402	4,058	2,520
- Capex	-1,108	-1,651	-1,000	-2,800	-700
Free cash flow	-995	1,733	1,402	1,258	1,820
- Dividend	-169	-281	-386	-517	-676
+ Equity raised	0	69	0	0	0
+ Debt raised	1,673	-617	-0	0	0
- Investments	181	15	0	0	0
- Minority Interest	0	0	0	0	0
- Misc Items	-695	-688	-715	-715	-715
Net cash flow	-5	230	300	26	428
+ Opening cash	15	10	17	317	343
Closing cash	10	15	317	343	771

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY16	FY17	FY18e	FY19e	FY20e
P/E(x)	17.5	22.6	31.6	23.6	17.9
P/CEPS(x)	9.74	13.73	20.39	15.45	12.44
Mcap/Sales	0.4	0.6	0.8	0.7	0.6
EV/EBIDTA(x)	7.8	10.2	13.5	11.0	8.9
RoE(%)	22.2	20.3	19.1	21.4	23.1
RoCE(%)	20.3	20.7	21.9	24.0	26.5
Fixed Asset Turnover (x)	6.4	5.8	6.4	6.2	7.3
Dividend Yield (%)	1.1	1.0	0.9	1.1	1.5
Dividend Payout (%)	23.3	19.3	20.0	20.0	20.0
Debt/Equity(x)	1.1	0.8	0.7	0.6	0.5
Debtors (days)	15	19	19	18	17
Revenue Growth (%)	34.3	7.9	17.4	19.2	17.1
PAT Growth (%)	58.0	45.0	10.3	33.8	30.9
EBIDTA Growth (%)	55.1	15.1	16.0	22.7	22.2
EPS Growth (%)	58.0	45.0	10.3	33.8	30.9
P/BV (x)	2.7	3.8	5.4	4.5	3.7

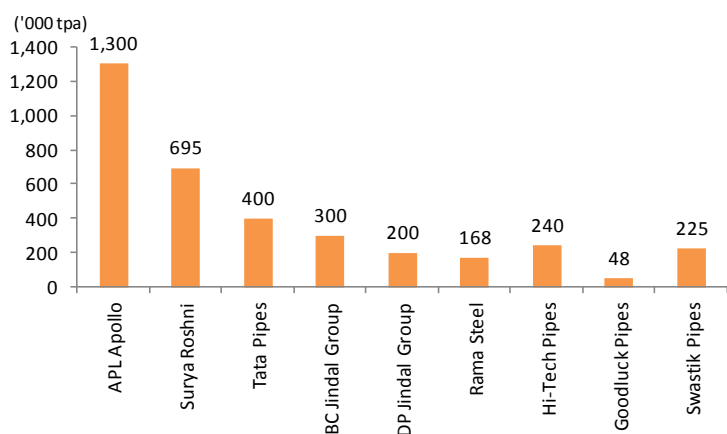
Source: Company, Systematix Institutional Research

Largest ERW pipe-maker, scale efficiencies to boost profitability

ERW industry clocking 9% CAGR...

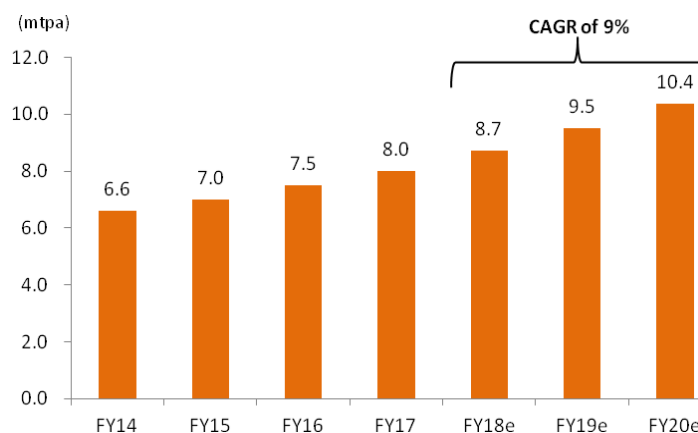
Electric Resistance Welded (ERW) pipe industry is witnessing a surge in demand from infrastructure, power and fabrication industries, which is in addition to the demand from traditional usage in water and gas transportation. ERW pipes, a 8mtpa industry, is moving from the unorganised to organised format, as smaller regional players are lagging larger ones in terms of scale, products portfolio and multiple location manufacturing facilities. Market is clocking a CAGR of 9% and is also expected to continue this momentum going forward. The industry is highly fragmented, with few large players holding ~50% of the share. There are over 1,000 SMEs in the unorganised segment operating with smaller capacities and mainly catering to regions within 100kms from their factories. Players have been concentrated in North India, in and around NCR, from where they used to supply to the entire country.

Chart 1: India's largest ERW pipe manufacturer



Source: Company, Systematix Institutional Research

Chart 2: Industry volume growing at CAGR of 9%

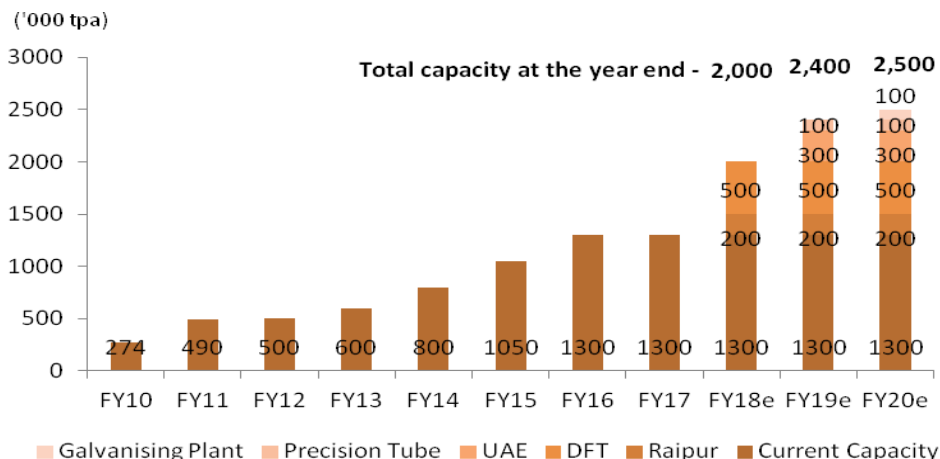


Source: Company, Systematix Institutional Research

...APAT's volumes grew at 26% CAGR during past 5 years...

APAT is the largest ERW pipe manufacturer in India, with 1.3mtpa operational and almost 0.7mtpa under-construction. Company's capacity and volumes have posted a CAGR of 21% and 26% respectively in the last five years, compared to an industry growth rate of 8-9%. Without any inorganic expansion, APAT has grown at a significant rate historically. Manufacturing plants near major demand centres, strong distribution and retail network pan India helped the company to sustain a high growth historically.

Chart 3: By FY20e capacity to be 2.5 mt

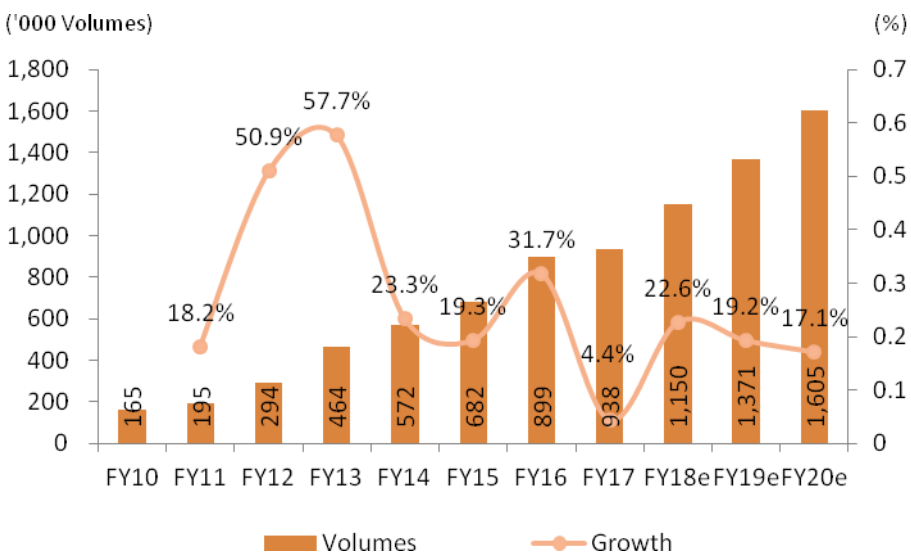


Source: Company, Systematix Institutional Research

...APAT's volumes expected to grow at 20% CAGR during FY17-20e.

APAT has embarked on a massive capacity expansion plan, with an aim to double capacity in five years to ~25lakh tpa, from the current 13lakh tpa, entailing an expenditure of Rs5bn. The additional capex would be used to set up a new plant in Raipur with 3 lakh tpa capacity, a new plant in the UAE with a total capacity of 3 lakh TPA and a green field unit to manufacture precision tubes for automotive applications in Bangalore, with a capacity of 1 lakh TPA. Company also plans to set up an in-line galvanizing plant of 1 lakh TPA capacity in Bangalore. However, the capex plan's highlight is the addition of almost 5 lakh tpa capacity through Direct Forming Technology (DFT). Company's Raipur plant has come on stream and is operating at optimum capacity utilisation. Regarding DFT, nearly four lines have been installed with an aim to install the rest before FY18-end. Backed by recent achievements, we expect company's volumes to post 20% CAGR during FY17-20e.

Chart 4: Volume to grow at CAGR of 20% during FY17-FY20e



Source: Company, Systematix Institutional Research

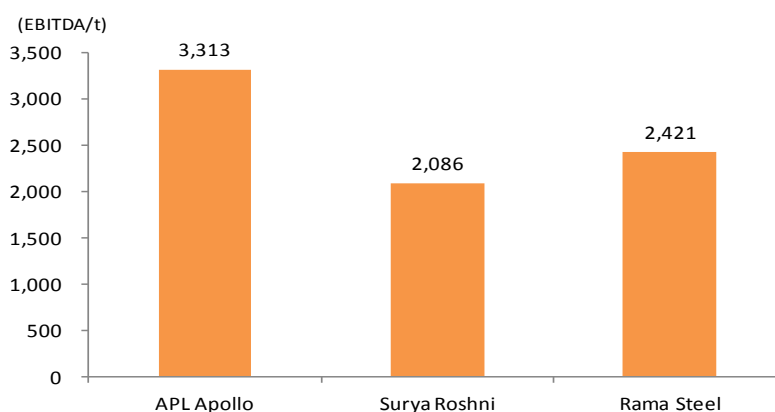
Commands premium due to scale, strong brand & widespread network

Despite operating in a fragmented and competitive market of steel tubes and pipes, APAT's products command a premium versus competitors. This is primarily due to a combination of factors like being the pioneer in adapting latest manufacturing technology, strong distribution and warehouse network spread across India coupled with a solid brand.

1) Economies of scale

By not tapping the market of ERW peers like Surya Roshni, Hi-Tech Pipes, Rama Steel and others, APAT expanded aggressively and took over the market share of inefficient and unorganised players. During this period, other organised players were highly comfortable working within their areas of expertise, while APAT gained market share and created a brand name in commoditized industry. In fact, APAT was the first player to replace wood and metal pipes in many applications, and introduce ERW pipes for PEB housing and other infrastructural uses. Hence, APAT is now the largest ERW pipe manufacturer, with the highest EBITDA/tn.

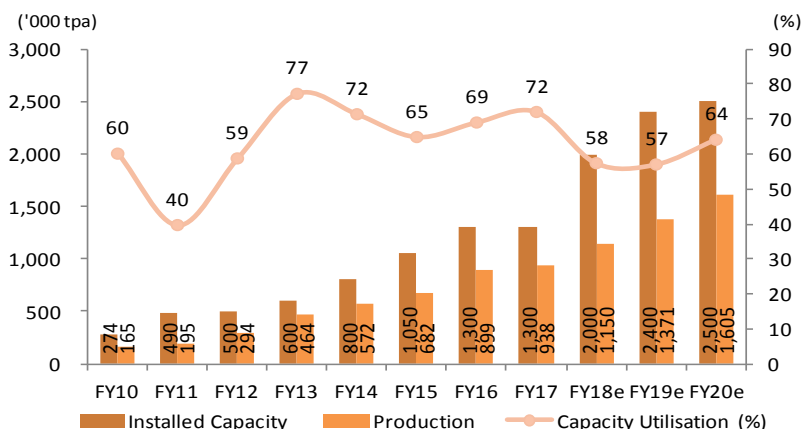
Chart 5: Most efficient & profitable ERW pipe player in India



Source: Company, Systematix Institutional Research

The capacity addition spree has come along with an efficient capacity utilisation of over 70% through the period. Despite adding capacities regularly, APAT ensured to boost volumes in tandem to reach an optimum capacity utilisation level in a short span of over three years. With the current mega expansion underway, we expect the company to portray a similar trend with respect to volume pick-up in tandem with capacity expansion. We estimate volumes to post a CAGR of 20% during FY17-20e.

Chart 6: Capacity utilization to improve



Source: Company, Systematix Institutional Research

2) Strong focus on brand-building

To create an impact on its brand 'APL APOLLO', company has chalked out a multi-pronged marketing strategy, which includes mass media advertising, experiential marketing techniques, web-based marketing initiatives and community building activities. This year, APAT's major thrust would be on differential marketing mode to popularise its new brand image. In sync with this strategy, company launched a new brand, 'Apollo Coastguard', to tap the growing consumption of galvanized steel tubes in coastal regions. Management highlighted that India's coastal market is witnessing a significant growth in the consumption of galvanized steel pipes, which is primarily used for roofing structures to provide shelter from rains and sunlight.

During the previous quarter, company soft-launched its 'Apollo Fabritech' brand to sell pipes manufactured through DFT medium. Management noted that initial responses from customers are significant and the company is getting repeat orders as well. APAT's hollow section is available in a wide products range. Also, beyond the standard requirements of industry, the company's production units are equipped to customise and deliver any special requirement in terms of sizes, quantity or surface finish as per customers' need. This is APAT's USP to command a premium in the market.

Table 1: One of the few ERW pipe manufacturers to create brand

Brand	Details	
Apollo Coastguard 	Manufacturing of galvanized steel tubes for coastal region Specification Range includes products from 1/2" – 8" inches outer diameter	
Apollo Fabritech 	Manufacturing of hollow pipes through DFT route Specification Size - 43 mm x 43 mm 55 mm x 20 mm 75 mm x 70 mm 198 mm x 170 mm 104 mm x 104 mm 195 mm x 195 mm	

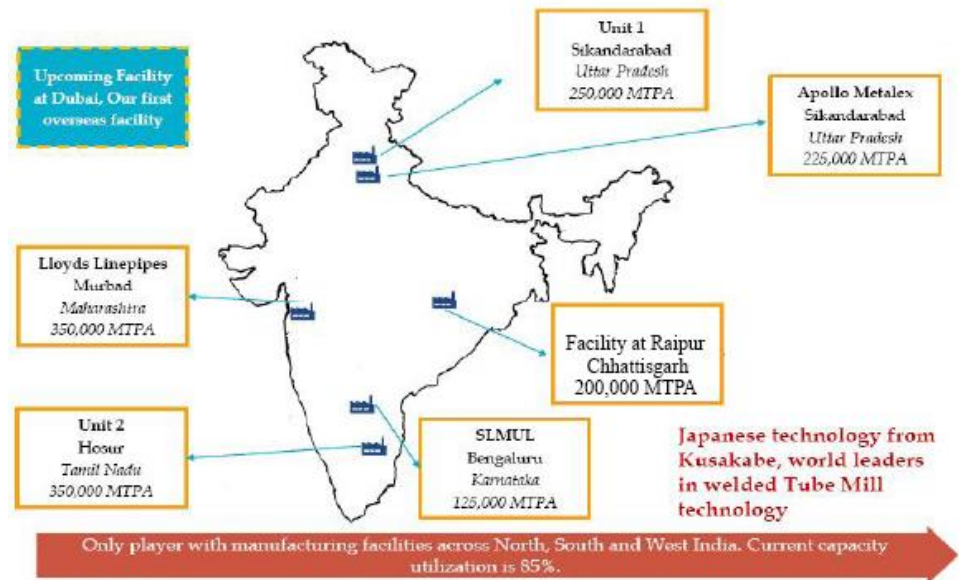
Source: Company, Systematix Institutional Research

Management underscored a strategic "branding campaign" to strengthen the roots of its brands, with an estimated capex of ~Rs250-300mn. We believe the mega exercise will aid to outpace competition from unorganised players, thereby helping APAT to reach a market share of ~20%, from the current 14%.

3) Shorter delivery time led by pan India manufacturing and distribution network

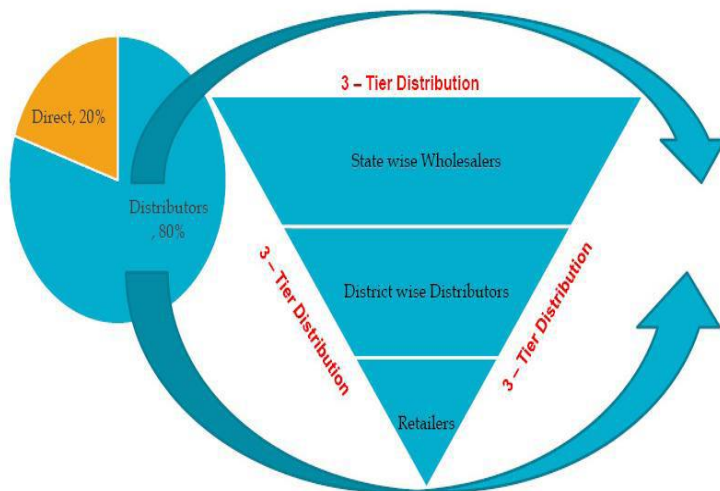
Company has created manufacturing capacities near major demand centres across India. Moreover, through its industry-leading distributor and warehouse network of >600 and 29 respectively, APAT is able to offer >400 products to end-point customers in a shortest span of time (average 10 days). This also saves logistic cost, as it is ~4% of the product cost. Through DFT, it expects to increase the products variety from the current basket, including sizes that were not easily available earlier to end-point customers.

Chart 7: Manufacturing facilities spread across India



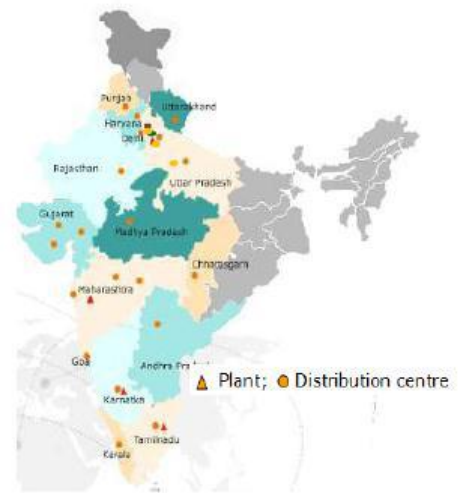
Source: Company, Systematix Institutional Research

Chart 8: B2C – supply chain



Source: Company, Systematix Institutional Research

Chart 9: Distribution network



Source: Company, Systematix Institutional Research

Value addition through DFT, to pave the way for export & OEM market

About DFT: After establishing in the competitive yet fragmented market of steel tubes and pipes, company forayed into the next phase of growth, led by installation of automated and globally accepted technology to manufacture hollow pipes through the DFT route. Unlike traditional technology, where round pipes were formed first and then converted to square or rectangular, DFT technology enables direct formation of hollow pipes of various size and shapes, thereby leading to cost saving. Hollow sections are formed directly through high-speed welding.

Chart 8: Direct Forming Technology



Source: Company, Systematix Institutional Research

Benefits of DFT: It will help in material saving of ~3%, as the new product will have sharper edges and material will not reside in corners, as it happens with the traditional technology -- sections are converted from round tubes. Company will also be able to produce pipes in smaller batches and take customised orders with higher margin. This brings certain advantages: the line can produce even smaller order sizes of 10-20 tonnes unlike traditional technology wherein larger batches of 400-500 tonnes had to be run before any change could be done. Also, products will be made to precision, with sharper edges and no bulges at ends. It will also help in the production of large-size tubes (200mmx200mm or 300mmx300mm), which are required by various equipment or bus body manufacturers and are largely imported currently.

DFT is strongly preferred in advanced countries due to economies of scale associated with its implementation, mainly reduction of roll-over time, less storage space and production of pipes with greater accuracy in terms of breadth and height. Pipes manufactured through DFT route command a premium versus conventional pipes and find international market due to the wide acceptance. APAT has recently commissioned four lines of DFT and plans to install further four lines by 4QFY18. It is operating at a run-rate of 8,000-10,000tpm and has plans to increase it to 15,000-20,000tpm going forward.

Access to global markets and OEM: DFT opened the door for the company to overseas market due to its acceptance among advanced countries and OEMs. In the OEM category, it is catering to companies operating in solar and PEB space. Management noted that DFT has started to gain momentum, with encouraging response from customers due to its superior quality. Currently, company is selling this product at par to its conventional product with a strategy to increase the price going forward, post acceptability among customers. In a short time span, APAT fetched nearly 8% of the consolidated revenue from overseas market and sales to OEM grew at 107% (due to a lower base). Management expects this to grow multifold, led by inherent advantages listed above.

Our view: Management noted it is witnessing EBITDA/tn exceeding >Rs4,000/tn for DFT-based products v/s ~Rs3,321/tn currently for customised products, while EBITDA/tn for standardised products remains same. We believe these levels of EBITDA/tn are substantially higher both on absolute and relative basis for a company operating in the ERW segment. Thus, we are not revising the EBITDA/tn estimate as of now but will revisit the numbers in FY19, once the entire DFT comes on-stream.

Table 2: Quarterly financial statement

Particulars	2QFY18	2QFY17	yoy	1QFY18	qoq
Income Statement	2QFY18	2QFY17	YoY	1QFY17	QoQ
Net Sales	13,454	9,555	41%	11,556	16%
Operating Expenses	12,441	8,733	42%	10,769	16%
EBITDA	1,013	822	23%	787	29%
Depreciation	124	168	-27%	122	1%
EBIT	889	653	36%	665	34%
Interest	208	160	30%	177	17%
Other Income	-55	21		95	
PBT	626	514	22%	584	7%
Taxes	219	177	24%	195	13%
Reported PAT	407	337	21%	389	5%
PAT Margin	3.0	3.5	(0.5)bps	3.4	(0.3)bps
EBITDA Margin	7.5	8.6	(1.1)bps	6.8	0.7bps

Source: Company, Systematix Institutional Research

Table 3: Volumes

Particulars	2QFY18	2QFY17	yoy	1QFY18	qoq
Black Pipes	1,94,036	1,59,904	21%	1,76,187	10%
GI Pipes	29,020	28,940	0%	29,066	0%
GP pipes	59,753	46,588	28%	59,902	0%
Coils & Others	14,050	10,458	34%	13,016	8%
Total	2,96,859	2,45,890	21%	2,78,171	7%

Source: Company, Systematix Institutional Research

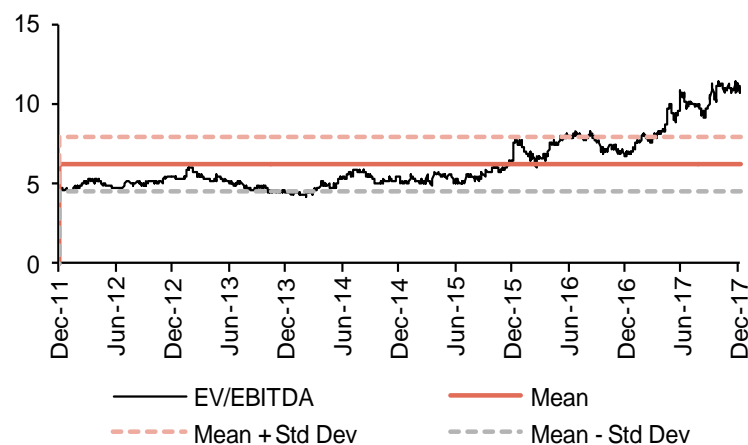
2QFY18 results highlight

APAT reported good numbers for 2QFY18, wherein revenue increased by 41/16% on a yoy/qoq basis to Rs13,454mn, mainly led by a combination of higher volumes (up by 20% yoy), realisation (up by 16% yoy) and new clients-win in the OEM segment. Total volumes for the quarter stood at 296,859mt, an increase of 20% on a yoy basis, due to higher sales of hollow & pre-galvanised tubes (up 22/30% yoy). EBITDA/t for 2Q rose to Rs3,410/t, from Rs2,829/t in 1QFY18. We expect APAT's growth to continue aided by a volume pick-up in the recently-commissioned Raipur plant coupled with DFT installation.

Valuation and view – deserves a premium valuation

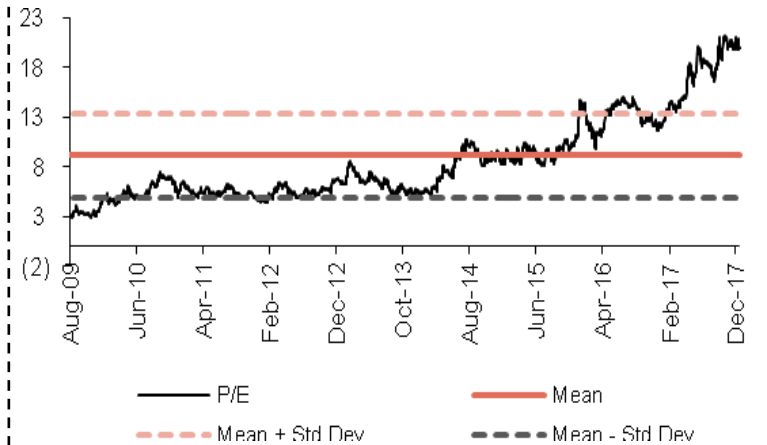
We expect APAT to deserve premium valuation as compared to its peers basically led by 1) market leading position in the overall fragmented market of ERW pipes and expanding capacity at 24% CAGR during FY17-20e 2) most efficient players in the market with EBITDA/t exceeding Rs3000 historically and is expected to further increase led by various developments highlighted above in the report 3) pioneer in adopting latest manufacturing technology and 4) pan India distribution reach. We apply 10x multiple on 1HFY20e EBITDA to arrive at a target price of Rs2,360.

Chart 10: Historic EV/EBITDA



Source: Company, Systematix Institutional Research

Chart 11: Historic P/E



Source: Company, Systematix Institutional Research

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