

2017

APL Apollo Tubes Ltd.



Initiating Coverage Report

**Tubes the very reason for
growth!**

Target: INR 2,411

APL Apollo

December 15, 2017

Initiating Coverage

Sector- Iron and Steel Products

CMP	1,874
Target Price	2411
% Up Side	29
Bloomberg Code	APAT@IN

Stock Info

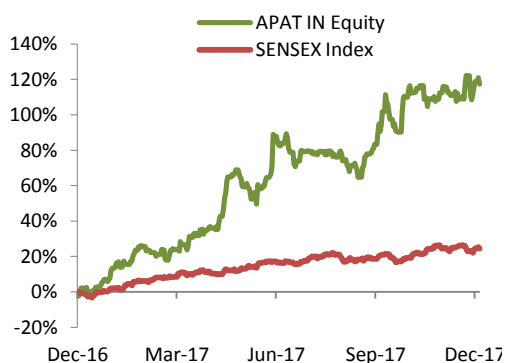
Face Value (INR)	10
Market Cap (INR Mn)	44,207
Beta	0.8
52 Week High/ Low	2,029/852
Average Daily Volume	18,998
Sensex	33,246
NIFTY	10,252

Shareholding Pattern (%)

Promoters	37.5
DII's	14.5
FII's	0.0
Others	48.1

% Change	1 M	6M	1Yr
Absolute	2	19	117
Relative	2	12	93

Stock Chart



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BUY

APL Apollo (APL Tubes) a leading player of ERW Steel Tubes and Pipes in India with a 12% market share makes a compelling investment proposition. We reason it owing to factors like largest capacity of 2MTPA by FY18 in a 7MTPA industry size, first mover in bringing the best of global technologies to India which is incomparable to peers, launch of innovative, patented and value added products, thrust on OEMs and Exports to de-risk its business model and more importantly its widespread and deep distribution network in Tier 2 and Tier 3 regions which is similar to some of the building material companies makes us believers of APL Apollo's "tubes the very reason for growth" argument.

Key Investment Arguments

Increasing capacity backed by new DFT technology, coupled with increasing market share to drive volumes: APL Apollo's growth story has been backed by continued capacity expansions, which has grown at 36% CAGR over the past decade followed by bringing in newer technology. APL Apollo stands poised to capitalise on rising demand from infrastructure, and shift from un-organized to organized, followed by superior products offering through DFT (Direct Forming Technology) under Hollow Pipes, GP & GI Pipes). Hence, we expect, APL Apollo to report a volume CAGR of ~17.9% over FY17-FY20E at over ~1.6MTPA driven by new technologies, branding and distribution network expansion in new geographies.

Better product mix, high volume growth to drive EBITDA/ton to improve return ratios: Over the past four fiscal years, EBITDA/ton for APL Apollo has witnessed a marked improvement (EBITDA/Tonne INR 2851 in FY14 vs INR 3314 in FY17) resulting out of better product mix from low margin Black Pipes to higher margin GI/GP pipes. Looking forward until FY20E, we remain positive on the company's operating profitability sustenance largely due to higher contribution from Value Added Products and increased brand awareness amongst end customers to allow pricing power vis-à-vis peers. Meanwhile, Company's RoE's are also expected to improve steadily from 22.7% in FY17 to 32.8% in FY20E with declining leverage levels. Net debt to equity would decline from 0.83x in FY17 to 0.69x in FY20E with interest coverage ratios improving from 4.7x in FY17 to 8.0 x in FY20 over the same period.

Valuations & View: We thus believe, the company is expected to post Revenue/EBITDA/Earnings CAGR of 18.4%/24.5%/34.3% respectively over FY17-FY20E driven by robust demand, higher volumes with capacity additions, improved profitability and lower interest costs. At CMP of Rs. 1,874 stock trades at 12.4x for FY20E, despite having reported an earnings CAGR in excess of 35% over FY14-FY17 period and consistent ROE improvement to 23% in FY17 over FY14 ROE of 15%. We expect, APL to clock ROEs in excess of 29% over FY18E/FY20E. We initiate coverage on **APL Apollo Tubes with a "BUY" rating and a target price of Rs. 2,411 per share over 12 months resulting in a 28% upside from current levels.**

Financials:

Rs In Mn	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	42,136	45,450	54,178	60,492	75,500
EBITDA	2,563	3,244	4,075	4,876	6,267
Net profit	1,006	1,459	1,918	2,511	3,556
EPS (Rs)	42.9	61.8	81.3	106.4	150.7
PE	36.21	30.1	22.9	17.6	12.4
EBITDA Margin	6.1%	7.1%	7.5%	8.1%	8.3%
PAT Margin	2.4%	3.2%	3.5%	4.2%	4.7%
ROE	21.9	22.7	24.7	27.6	32.8

Source: Company, SMC Institutional Research

Company Brief:

APL Apollo Tubes Ltd. was established in 1986 as Bihar Tubes Pvt. Ltd. and started the production of MS Black pipes at its Sikandarabad unit with an initial capacity of 6,000 MTPA. Within 3 years it scaled up its capacity to 24,000 MTPA and today with total installed capacity of 1,300,000 MTPA it is the leading manufacturer of ERW Steel tubes and pipes in India. The capacity expansion and Pan-India presence has been a result of both organic and inorganic growth; APL has three wholly owned subsidiaries:

- **Apollo Metalex Pvt. Ltd – Acquired in 2007 as a measure of backward integration**
- **Shri Lakshmi Metal Udyog Ltd. - Acquired in 2008 for penetrating in South India**
- **Lloyds Line Pipes Ltd. – Acquired in 2010 to extend footprint to West India**

It has been a pioneer in bringing advanced global technologies to India and has also successfully forayed into manufacturing niche steel products (window and door frames) apart from its pipes and tubes portfolio. APL has also, over the years established a vast distribution network which today is made up of over 600 distributors, 40,000 retailers and 26 warehouses cum branches that give a country wide presence to its portfolio of over 400 products. It also exports to over 35 countries worldwide.

Pan India Manufacturing Presence & Warehouses

Amongst the peers in the Indian ERW pipe segment, APL Apollo is the only company which has a pan India manufacturing presence ensuring proximity to its end customers and to also localize supply thereby fast tracking its growth. Currently the company has a total capacity of 1.3MTPA which following commercialization of green field plant at Raipur and installation of DFT Technology lines will enhance the total capacity to 2.0MTPA allowing it to march well ahead of peers in the segment.

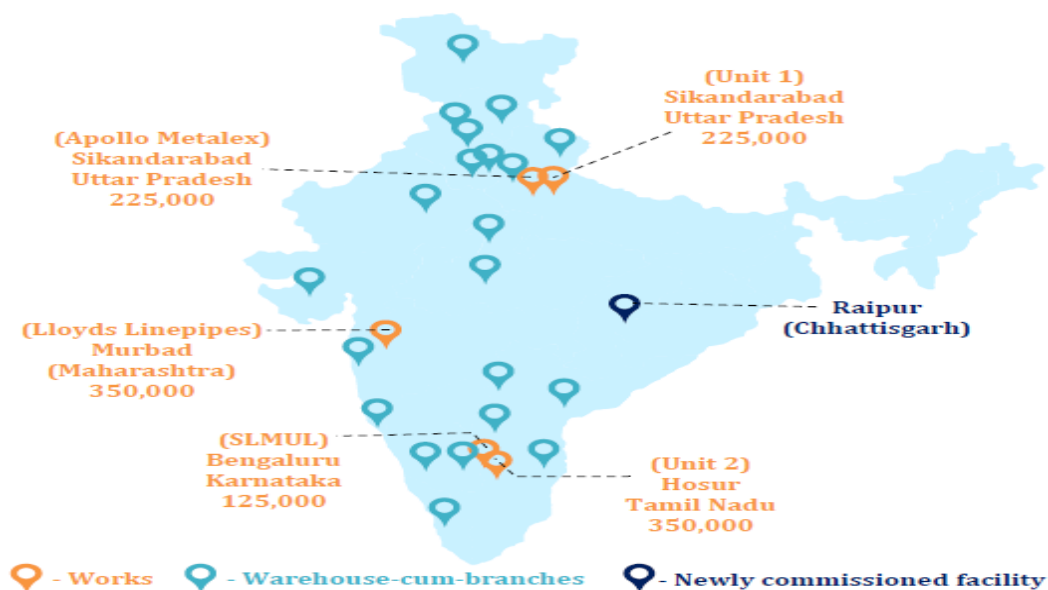
Exhibit 1:

Zone	Manufacturing Plant	Location	Capacity (TPA)	DFT (Planned)	Total Capacity (TPA)
North	Unit 1	Sikandarabad, UP	2,50,000	1,25,000	3,75,000
	Apollo Metalex	Sikandarabad, UP	2,25,000	-	2,25,000
West	Lloyds Line Pipes	Murbad, Maharashtra	3,50,000	1,25,000	4,75,000
South	Unit 2	Hosur, Tamil Nadu	3,50,000	1,25,000	4,75,000
	SLMUL	Bengaluru, Karnataka	1,25,000	-	1,25,000
East	Raipur	Raipur, Chhatisgarh	2,00,000	1,25,000	3,25,000
Total			15,00,000	5,00,000	20,00,000

Source: Company, SMC Institutional Research

As a part of its VISION 2020 plan, APL plans to increase the total installed capacity to 2.5mn MTPA by FY2020 to become the largest ERW pipe manufacturer in the world. This, we believe would be achievable only on the back of its ability to sustain the faster than industry growth rate it has reported thus far and that would be driven by various initiatives taken by the management (thrust on OEMs, Exports, Branding initiative etc) to remain ahead of the curve.

Exhibit 2: Warehouse cum Branch Network



Source: Company, SMC Institutional Research

APL Apollo Tubes Product Range & Industries Served:

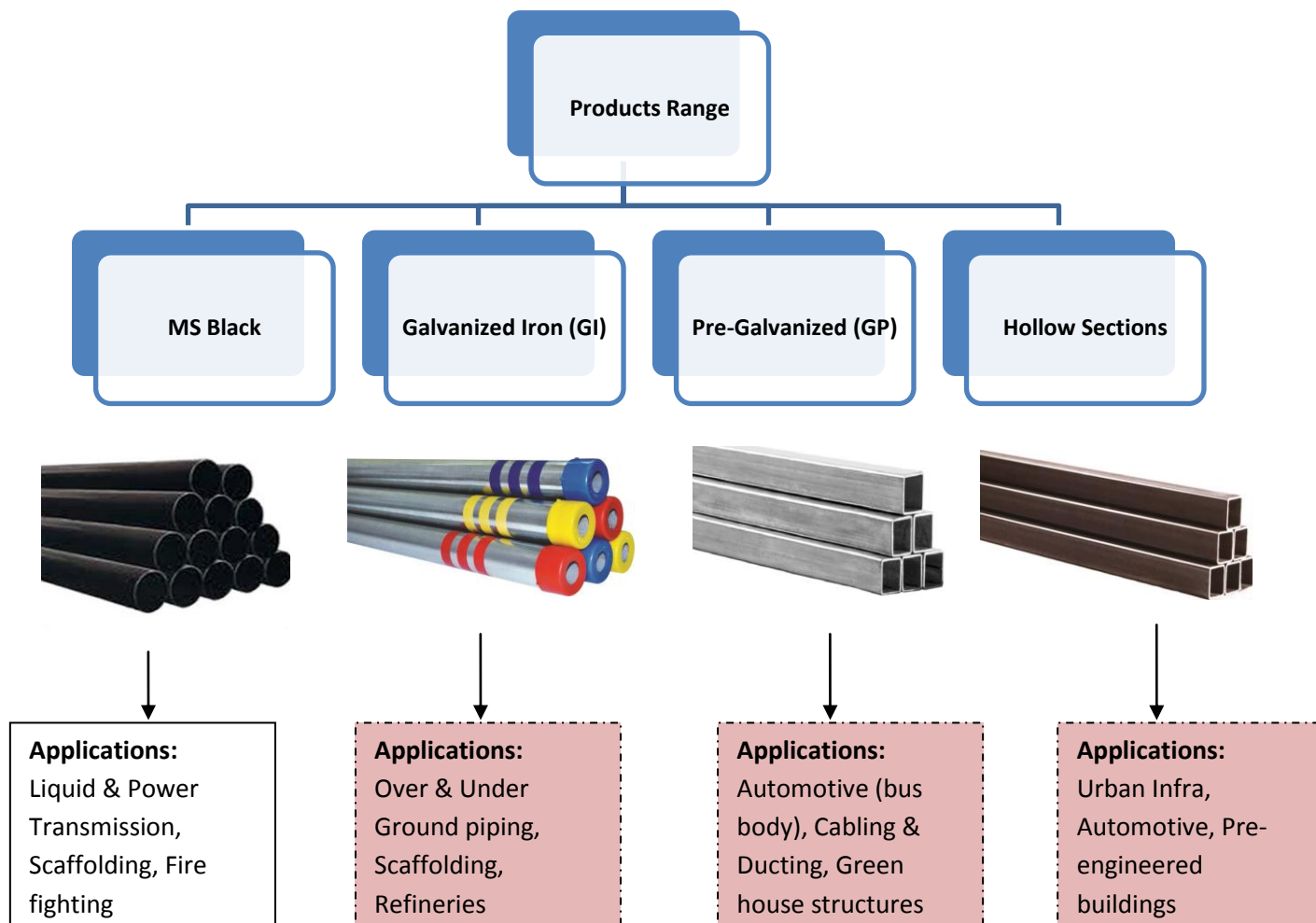
APL Apollo operates in the ERW (structural & commercial) pipes and tubes segment. It is the largest manufacturer in India with an existing production capacity of 1.3mn MTPA (closest competitor's capacity being less than half). The industry which comprised of large number of unorganized players would now be benefitted due to shift from unorganized to organized following implementation of GST. This is indeed a long term positive for APL Apollo Tubes.

Exhibit 3: End-users of APL Apollo are Core sectors of Indian Economy



Source: Company, SMC Institutional Research

Exhibit 4: Products Range



Source: Company, SMC Institutional Research

Amongst the leading players in the Indian ERW Industry, APL Apollo Tubes has a portfolio of over 400 products across various shapes, sizes and properties, a key advantage that gives it a larger market out-reach compared to competition and thus enhanced visibility. APL's range spans from the basic MS Black Round Pipes which primarily find use in liquid transmission to the GP Pipes made from pre-galvanized sheets, for which APL was the first to introduce in India and now the thrust on square and rectangular hollow sections manufactured using the DFT technology.

MS Black Tubes

MS Black Tubes was the first product manufactured by APL when it commenced operations in 1987 and today it is amongst the largest manufacturers of the same in the country. Coated with protective oil or a black lacquer base, these tubes are rust free and require low maintenance. The domestic market for MS Black is extremely competitive with large number of players; the export potential too has shrunk over the years. Hence APL's management has taken a well thought out decision to focus on fast growing GI/GP pipes and tubes along with Hollow Sections products.

Galvanized Iron (GI) Tubes

Galvanized tubes are steel tubes that are dipped in molten zinc (galvanization process) to impart a layer of zinc which protects the tube from aging and rusting. Owing to their resistance to corrosion, GI Tubes are preferred by designers and builders for structural applications. Management has alluded on plans to increase GI capacity from current 120,000 MTPA to 200,000 MTPA in the coming year.

Pre-Galvanized (GP) Tubes

In contrast to GI tubes which are dipped in a zinc bath for galvanizing, GP Tubes are made from pre-galvanized sheets. APL was the first company to introduce GP Tubes in the country and its two subsidiaries (Apollo Metalex and Shri Lakshmi Metal Udyog) were integrated backwards with in-house sheet galvanizing facilities. APL Coastguard is one such successful brand under which the company has been selling GP pipes in Kerala and its surrounding coastal regions. Moreover, the company has ramped up its GP capacity from ~180,000 MTPA to ~240,000 MTPA in FY17.

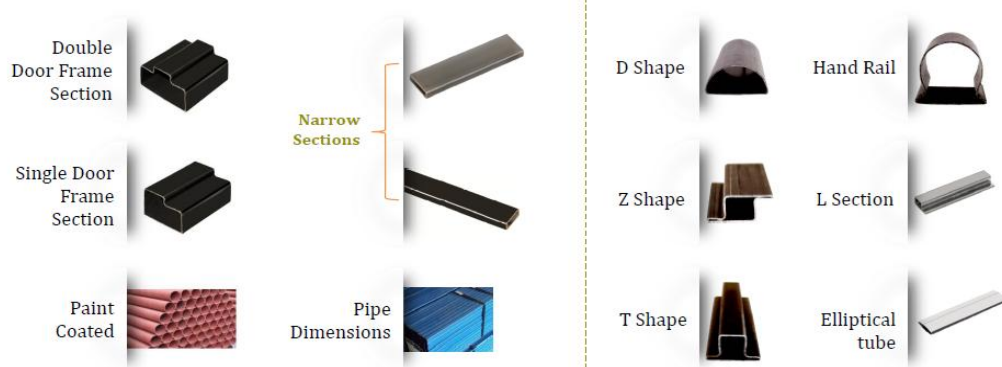
Hollow Sections

Square and Rectangular Hollow Sections emerged as an excellent alternative to steel channels, angles and beams in construction and engineering applications owing to their high compressive strength, tensile capacity and superior fire resistance. Augmenting its play in this category, APL is bringing to India the latest global technology (Direct Forming Technology) to manufacture square and rectangular hollow sections by customizing them as per end user requirements.

APL boasts of a portfolio of over 400 products across various shapes, sizes and properties, a key advantage that gives it a larger market outreach compared to competition. Color coated pipes is another concept brought to India by APL Apollo whereby all kinds (MS Black, GP, GI and Hollow Sections) of pipes can be color coated at the production stage itself, a relatively cheaper process to enhance the aesthetics as well as prevent rusting of pipes.

Exhibit 5: Most Diversified Product Basket of 400+ varieties

70% of APL Apollo's product portfolio has limited competition



Source: Company, SMC Institutional Research

We note, the company's products are unique and thus face limited competition from both organized as well as unorganized players in the ERW pipe segment.

Exhibit 6: Marquee Clientele

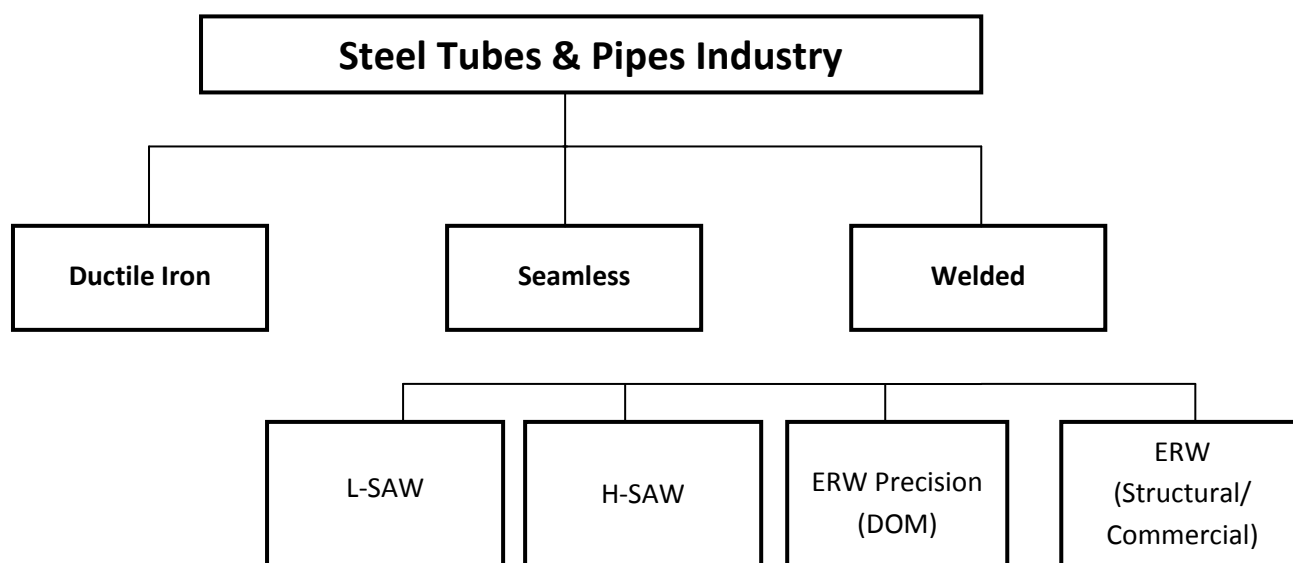
Industry	Clientele
Infrastructure	Delhi Metro, Mumbai Metro, Bengaluru Metro, Hyderabad Metro, Kolkata Metro and Jaipur Metro L&T, Gammon, Afcons, BL Kashyap, CPWD, GMR, Engineers India, MHADA, ACE etc.
Pre-Engineering	Zamil, Kirby, Tigar, Pennar to name a few
Power & Gas	BHEL, HP, IGL, MRPL, NTPC, Gujarat Gas, BP, Suzlon, Cairn Energy, Susten
Corporates	Tata, Ashok Leyland, SAIL, DLF, Adani, Reliance,

Source: Company, SMC Institutional Research

Industry Structure & Dynamics:

Pipes and Tubes are most commonly used for flowing materials including Oil & Gas, water, chemicals etc., besides the engineering and infrastructure applications. The Industry can be broadly segmented into Plastic and Steel Pipes and Tubes, both with distinct properties, applications, benefits and drawbacks. Plastic pipes which use Polyvinyl chloride (PVC) as the major raw material largely find use in irrigation for agriculture, potable water supply and waste water treatment. Whereas because of their resistance to corrosion, high tensile strength and longevity, Steel pipes and tubes are preferred for Oil & Gas, power, engineering and structural support system applications.

Exhibit 7: Industry Structure



Source: Company, SMC Institutional Research

While, the industry is diverse having different types of pipes, the exhibit below showcases, the presence of APL Apollo Tubes in the industry against some of the listed and unlisted players across the segments.

The global steel industry has an approximate market size of USD 1,000 Bn in value terms and in volume terms it is ~ 1,700 Mn TPA. Of the total steel industry across the world, welded steel segment has a value market of USD 100 Bn with a volume market of ~170Mn TPA. Of this, the Indian ERW steel industry market has a total market size of 8Mn TPA in terms of volumes which translates into USD 5 Bn. (~INR. 32,500 Cr.) of the Indian market, APL Apollo Tubes is the leader.

Exhibit 8: APL Apollo Tubes Industry Positioning vis-a-vis peers

	Ductile Iron (DI)	Seamless	LSAW	HSAW	ERW Precision (DOM)	ERW (Structural/ Commercial)
Size (Diameter)	3" - 40"	0.5"-14"	16"-50"	18"-120"	0.5"-4.5"	0.5"-22"
Key Raw Material	Pig Iron/ Cast Iron/ Sponge Iron	Steel Billets	Steel Plates	HR Coils	HR Coils	HR Coils
Application	Potable Water & Sewage Transportation	Oil & Gas, Engineering Power & Automotive	Oil & Gas Transport	Oil & Gas/ Water Transportation	Automotive & White Goods	Urban Infrastructure, Industrial, General Engineering, Oil & Gas (city gas distribution)
Key Players	Jindal SAW, Electrosteel	Maharashtra Seamless, Jindal SAW,	Jindal SAW, Welspun Corp, Man Industries	Jindal SAW, Welspun Corp, Man Industries, PSL, Ratnamani Metals	Tata Steel, Innoventive, TII	APL Apollo Surya Roshni, Tata Steel, Welspun Corp, Jindal Pipes, Maharashtra Seamless

Source: Company, SMC Institutional Research

Oil & Gas is the largest user of pipes and tubes as pipelines are the major mode of transport for petroleum, oil and lubricant products. The global Oil & Gas industry has over the years been a significant revenue generator for the Indian steel tubes and pipes industry. While the Seamless category of pipes have been used in exploration and production, Horizontal Submerged Arc Welded (HSAW), Longitudinal Submerged Arc Welded (LSAW) and Electric Resistance Welded (ERW) pipes have come to use for transportation. The domestic market potential isn't any less promising with India's energy demand burgeoning, propelled by a growing economy and demographic expansion.

More recently, apart from the traditional use for transportation of liquids and gases, steel tubes and pipes, particularly the ERW category has increasingly found application as hollow support structure at airports, malls, metro stations, pre-engineered buildings etc. Besides these urban infrastructure applications, ERW pipes and tubes are fast emerging as replacements to certain traditional aluminum and wooden parts in trucks and bus bodies. Today India is counted as one of the leading ERW steel tubes manufacturing countries alongside China, Turkey, Italy and US with a domestic production capacity of ~7Mn TPA.

The domestic ERW steel pipes and tubes market is estimated to be worth over USD 5 Bn (INR ~32,500 Cr) and is expected to grow at 9% CAGR through FY19 led by significant opportunities in city gas distribution and urban infrastructure development on the back of the Government's various initiatives like Housing for All by 2022, AMRUT and Smart Cities Mission.

Exhibit 9: ERW Pipes and Tubes Applications

Areas	Applications	Attributes
Urban Infrastructure	<ul style="list-style-type: none"> • Airport Terminals • Foot Over Bridges • Metro Stations • Sports Stadiums • Sign Support Structure 	<ul style="list-style-type: none"> • High tensile strength • Ease of Fabrication • Lightweight
Industrial	<ul style="list-style-type: none"> • Factory Sheds • Material Storage Racks • Conveyor Gantry • Drilling Rig 	<ul style="list-style-type: none"> • High strength-to-weight ratio • Free from sharp edges • Ease of erection
General Engineering	<ul style="list-style-type: none"> • Truck & Bus Body • Automobile Chassis • Greenhouse Structures • Scaffolding • Gym Equipment 	<ul style="list-style-type: none"> • Aesthetic Appeal • Lightweight • Ease of Fabrication

Source: Company, SMC Institutional Research

Thrust on End-user Segments:

Growth in construction & infrastructure segment to boost demand

Steel pipes have lately found applications in real estate, construction, telecom, power, energy, entertainment zones, metros, airports and ports. They are used in the building, construction & infrastructure segments and have a variety of applications, such as conduits, support structures, fencing, railings and scaffolding. Delay in project awards, clearances and poor company financials slowed investments in the construction segment over the past couple of years. With the government's renewed focus on the infrastructure segment aided by a slew of policy reforms, we expect investments and construction in the infrastructure segment to gather pace. The Indian Government, under the 'Make in India' campaign has announced \$1trillion investments for infrastructure sector. The central government has significantly increased its focus on the development of infrastructure in India. It has significantly increased the allocation of key infrastructure-focused sectors like roads, highways and urban development. It is projected that India would need about USD 64 Bn worth of investment in the infrastructure sector over the next five years of which 70% would be towards power, roads and urban infrastructure sectors.

Metro rails : demand for new wagons

Increasing urbanization and an inability to widen roads demands higher investments in alternative modes of transport, such as metros. With the success of the Delhi Metro, India has planned to invest USD 30 Bn over the next five years into metro projects. Demand for new wagons for these projects will boost demand for steel pipes.

Smart Cities to support steel pipe demand

The Smart City Mission was launched in June 2015 and plans to develop 100 smart cities across India under this program within five years at an estimated cost of Rs. 48,000 Cr. Within a year of its launch, 33 cities have already been selected in the first phase, Although we do not expect work to be completed within the stipulated time, there has been good headway and investments to drive construction activities (as most proposals indicate projects are construction-intensive), which likely will support demand for steel pipes, especially in the structural segment. 17 out of 33 cities have already formed their special purpose vehicles (SPV) and a few also have floated tenders for some projects. The development of Smart Cities also entails developing a better infrastructure and thus will

witness growing demand for Airports and commercial complexes thereby leading to growing demand for steel structures.

Housing for All by 2022 to boost steel pipe demand

The Pradhan Mantri Awas Yojna (Urban) programme launched by the Ministry of Housing and Urban Poverty Alleviation in June 2015 envisions providing affordable housing for urban poor. With an aim to construct 20mn houses, this program also augurs well for steel pipes, which are used as structurals. In addition to this, water supply and sanitation too would be necessary to ensure quality of life for the beneficiaries of the Housing for All by 2022 project (namely Economically Weaker Sections and Low Income Group housing projects). Thus to provide for drinking water, sanitation and sewage infrastructure, steel pipes which augurs well for steel tubes and pipe manufacturers like APL Apollo. As per Census 2011, about 53% of households lack sanitation facilities.

Solar Energy

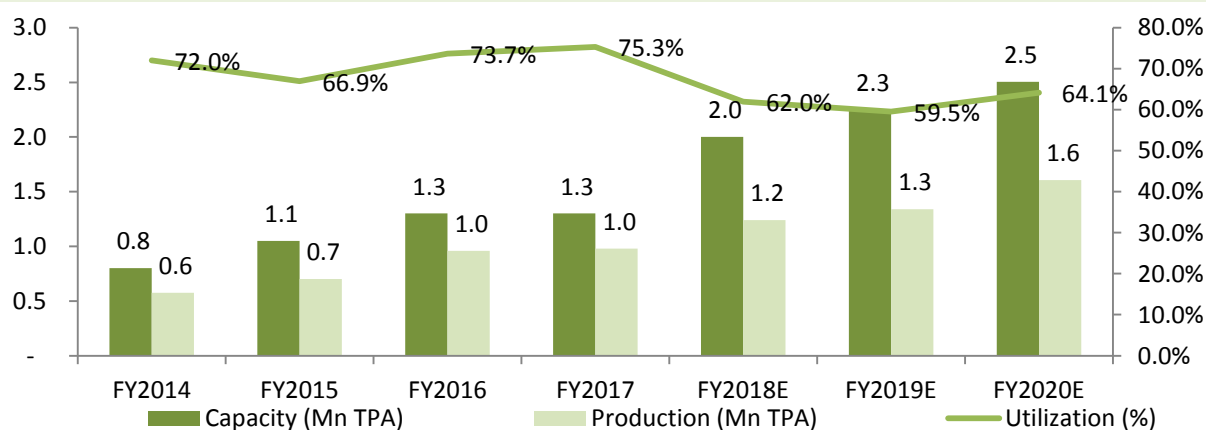
The government's focus on the usage of renewable energy resources to fuel the economic development while reducing the carbon footprints has led to the ambitious target of generating 100 GW of solar energy by 2022. This is a mammoth opportunity for manufacturing steel companies to cater the huge demand of meeting India's solar power energy requirement.

APL Apollo's Distinctive Business Model:

- 1) Largest manufacturer of ERW pipes in India supported by strong volume growth and capacity expansions: ERW Pipes has a total industry size of Rs. 32,500 Cr/ 7Mn TPA. In terms of capacities, the company has a total installed capacity of 1.3Mn TPA which it intends to expand to 2.0Mn TPA by end of FY2018. Indian ERW market is growing at a rate of 9-10% while, APL Apollo Tubes has been growing over 20%. The confidence stems from the fact, that structural occupy a dominant position in the ERW pipes and the share of structural pipes has only seen a growth over a period of time. APL Apollo Tubes is primarily focused on the structural space, which currently accounts for ~70% of its overall portfolio vs ~55% in FY13.

Strong growth reported by APL Apollo has been backed by continued capacity expansions, which grew at 36% CAGR over the past decade from 80KTPA in 2007 to its current 1.3Mn TPA. This has been achieved by growing organically as well as inorganically. Its major acquisitions included Apollo Metallex Pvt. Ltd. in 2007, Shri Laxmi Metal Udyog Ltd. in 2008 and Lloyds Linepipes Ltd. in 2012. In sync with the capacity growth, the volumes have also grown at 35% CAGR over the past decade. The management is confident of sustaining its ahead of the industry growth rates due to market share gains from organized as well as unorganized players and other strategic initiatives taken by the management to remain ahead of the curve.

Exhibit 10: Strong Volume Growth



Source: Company, SMC Institutional Research

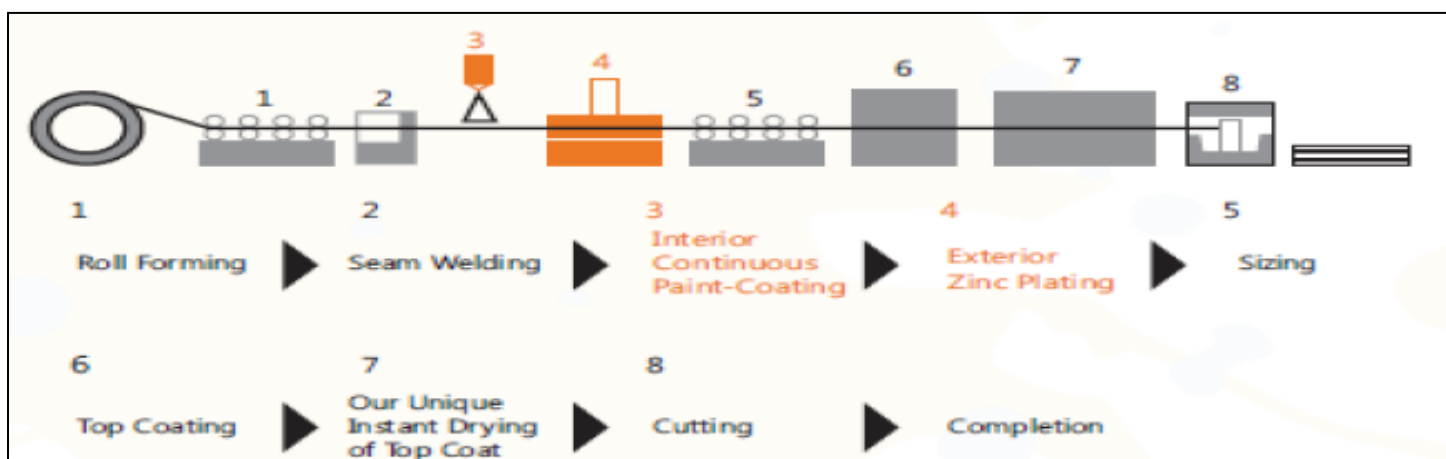
Leadership position of APL Apollo in the ERW Pipes segment has been accorded:

- a) Growth in capacities both organic and inorganic and b) market share gains from competition in the organized as well as unorganized segments in which capacity of industry grew much slower than APL.

2) **Pioneer in introducing Innovative Technology in the Indian market:**

The Company has been a pioneer in launching colour coated and Pre-Galvanized pipes in the domestic markets. It is also the 1st to introduce latest global technology 'Direct Forming Technology (DFT)' and 'In-line Gavanizing' in India. DFT is the latest global technology of making hollow section / pipes of superior quality which reduces rollover time significantly. Introduction of new technology allows APL to expand its addressable market thus aiding volume growth target of over 20% over the next few years. In-line Galvanizing Technology is the latest zinc plating and coating technology where in tube making and galvanizing is performed simultaneously thereby making the process of secondary operations of hot-dip galvanizing after tube is formed redundant. Due to this, the In-line Galvanizing Technology offers key benefits to customers by way of offering a superior quality product (minimal human intervention) with cost efficiency at its core.

Exhibit 11: Manufacturing Process



Source: Company, SMC Institutional Research

- 3) **Direct Forming Technology (DFT) adding on to its tech expertise:** APL has over the past years been active in adopting latest technologies which include its Strip Galvanizing Lines, Cold Saws and High Speed Mills sourced from Europe that helped them increase processing speed by 5x. Direct Forming Technology (DFT) used in manufacturing Hollow Sections is the latest technology that APL is betting upon and is the first company to bring DFT to India. Earlier, to manufacture square and rectangular pipes, it had to first form round pipes and then process it to get the desired shape.

Exhibit 12: Direct Forming Technology (DFT)



Source: Company, SMC Institutional Research

DFT would however alleviate the need to do this and help them form square and rectangular pipes directly. This would bring along a number of benefits and opportunities:

- a) **3-10% Savings on RM:** DFT would eliminate the wastage which earlier used to gather at the edges when round pipes were converted into square or rectangular pipes. Savings in the range of 3-10% on RM costs are expected on the back of this.
- b) **Customized/Small orders to drive market share gains:** Introduction of DFT would enable APL to produce pipes in smaller batches, as low as 10-20MT against the traditional requirement of having to process 400-550MT before making any changes. Thus, the ability to accept small orders in customized sizes would enable it to serve a larger part of the market. Besides, customization will also allow APL Apollo Tubes to be the first to offer its customers the size which just meets their requirement. Testimony to this customization is the introduction of 300x300mm size in India for the first time in India and being the sole producer of the same. Having received encouraging response to customized sizes, the company has already developed 12 new sizes which APL shall leverage upon going forward.
- c) **Entry into new industries:** The management expects to make inroads into new industries such as Truck & Bus Body, Agricultural Implements, Gym/Sports Equipment, Solar Tracking systems etc. led by the acceptance of the superior quality products as a result of the new technology.

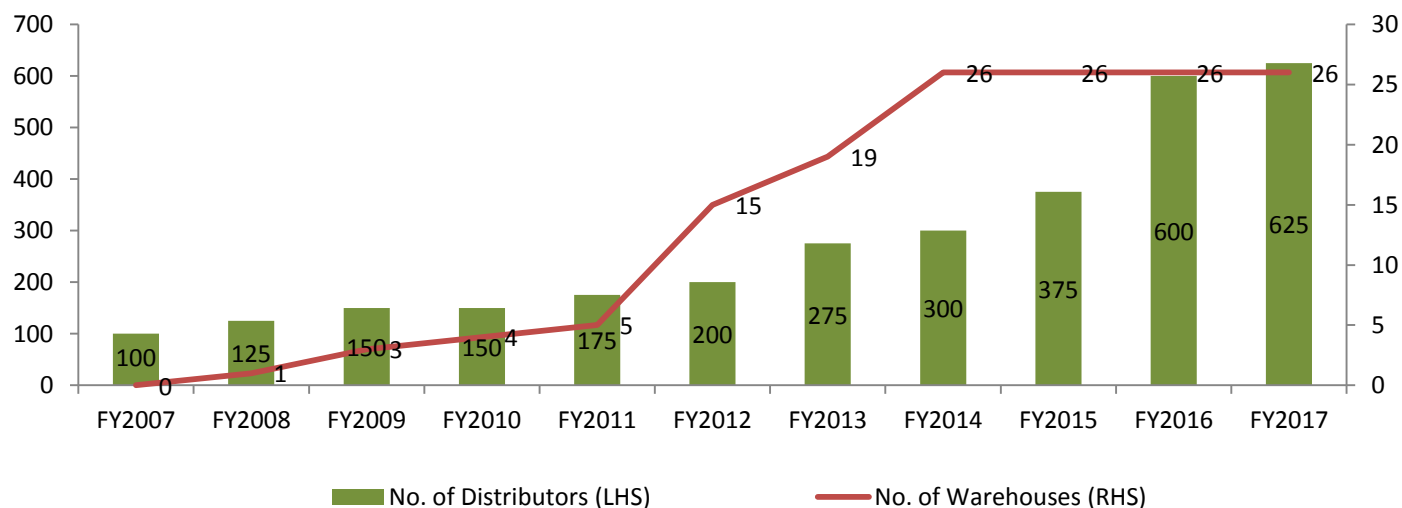
- d) **Export opportunities:** Export markets of Europe, Japan and USA hold strong potential as DFT products are well accepted in these advanced economies. The management is betting on DFT to be a key catalyst in ramping up its export sales, targeting exports to continue growing at 50% or more.

By internally funding the capex of INR 2,000 Mn (INR 1250 Mn towards Machinery and INR 750Mn towards installation and erection) the company is looking to build initial DFT Capacity of 500,000MTPA. Already having commissioned 2 out of the total 9 mills of DFT, one each at Hosur and Raipur plant, the remaining lines will come fully on stream across all its plants by end of FY18E as guided by the management. This DFT Technology is likely to be a game-changer for both, the company and industry in India.

- 4) **Widespread Distribution Network and diverse Product basket a key moat:** With about 625 distributors now, the company has carved a niche for itself in the steel tubes and pipes industry in terms of catering to the end consumer. This industry essentially functions on the wholesaler/ B2B model instead of a B2C model (a three-tier distribution network) which is similar to the distribution network of some companies/ businesses present in the building materials space. This we believe, is a niche and a significant economic moat consciously created by the company over the years and which we believe is difficult to replicate by peers/competition in the Indian markets given the diverse set of consumers.

APL Apollo Tubes offers over 400 varieties of steel tubes and pipes across segments. This is one of the largest product portfolio offered by a company present in the tubes segment which includes Hollow Sections, GI/GP Pipes that find application in the construction, urban infrastructure, solar plants, irrigation, energy, affordable housing segments. Introduction of new products like Door Frames, Window frames, hand rail, T-Section, Narrow & Small sections which cater to the affordable housing segment ensures lowering cost of construction of a new house and thus throws open new growth avenues. Additionally, Central Government's thrust on SMART Cities, Urban Infrastructure, Renewable Energy (Solar Energy in particular) etc. offer fast growing opportunities to APL Apollo. We believe that APL Apollo Tubes, owing to its constant innovations has been able to develop new products (patents in some) to its end customers thereby creating new value propositions for the end consumers and in-turn strengthening its brand. Management also indicated that Shankara Building Products a leading building materials company is amongst their largest distributor in South India. With bright growth prospects for Shankara Building Products, we believe the prospects of APL Apollo Tubes are also promising as APL Apollo is emerging as the largest manufacturer of Structural Pipes in India. Further, what is to advantage of APL Apollo is there is no single customer concentration risk. No single customer forms more than 5% of the total revenues thus de-risking its revenue model.

Exhibit 13: No of Distributors



Source: Company, SMC Institutional Research

- 5) **Branding initiative; right foot forward:** The largest manufacturer of ERW pipes in the Indian markets and offering wide product specifications to its customers, APL has earned a distinctive name for itself in the domestic steel tubes & pipes industry. Further, to enhance its edge over competitors, the company through various brand building and brand awareness initiatives has been able to turnaround itself and its image from a pure commodity player to a branded steel tubes and value added products manufacturer. Though these efforts have been directed across all markets, the thrust has largely been on increasing the brand visibility in Tier 2 and Tier 3 cities through billboards, wall paintings, in-shop signage, van activation programs and bus branding. Further, to engage with channel partners (dealers and distributors) and end users (fabricators, consultants, plumbers, farmers etc.) who largely drive business for APL, it has been active in organizing pan India meets for fabricators, plumbers, besides dealers to establish its presence, brand recall and higher loyalty; a typical of a consumer driven product company. The branding efforts coupled with an extensive basket of products have helped APL expand its Pan India network of distributors (contributing ~80% to total sales) to 600 direct distributors as on FY17 from just 200 distributors in FY12. To enhance its branding initiative, the company has appointed a brand consultant thereby investing INR 250Mn towards this activity. We believe, APL Apollo has taken the right foot forward to build a strong entry barrier to competition.
- 6) **Greenfield Project in Raipur; gateway to Eastern India:** With existing facilities spread across North, West and South of India, APL has moved towards establishing a pan India manufacturing footprint by setting up a green-field facility in Raipur, Chhattisgarh. Essentially, the plant in Raipur will give them closer access to the markets of Chhattisgarh, Bihar, Orissa, West Bengal, Andhra Pradesh, Eastern UP (new BJP Government will lay a lot of emphasis on infrastructure development), Madhya Pradesh and parts of Maharashtra (like Nagpur) thus enabling it to serve the Eastern and part of Central region which has a total market size of 1-1.25MTPA. Of this, APL aims to capture a significant share with a total capacity of 3.25TPA expected to come on stream in stages by Q4FY18. Incurring total capex in the range of INR 1,200-1350 Mn to be met through internal accruals, it would be setting up 6 manufacturing lines comprising of:

- a) 3 DFT technology enabled lines - 125,000 MTPA
- b) 3 Regular lines - 200,000 MTPA

While the existing players in the largely unorganized Eastern market have focused on MS Black pipes, APL is aiming to make inroads by manufacturing and marketing the higher margin square and rectangular hollow sections and GI/GP pipes. Additionally, APL will also enjoy much lower logistic costs (freight cost) and proximity to some of the fast growing towns and cities in the eastern parts of India. This facility will therefore open up new and promising avenues of growth for APL Apollo Tubes over FY18 and FY19 and beyond.

- 7) **GST a boon for APL** – With ~40% of the market being unorganized, GST hailed as India's biggest and most notable tax reform has opened up new opportunities for APL. The advantage APL could capitalize upon is the shift of business from unorganised to organized segment. This augurs well for further strengthening its leadership positioning in the Indian Steel Tubes and Pipes segment. APL Apollo has close to 12% market share which could increase going ahead in our opinion owing to GST.
- 8) **Thrust on Exports to aid revenue growth over FY19E/FY20E:** Currently, Exports forms 6%/4% of the Total Volumes/Revenues respectively. APL Apollo, has set itself a target of increasing its exports to 10-15% over the coming 3-4 years. Exports over FY12-FY17 have reported a 10% CAGR. The theme for Export growth will hinge upon better product quality (DFT) at competitive prices in comparison to other European steel tube and pipes manufacturers. At present APL's exports largely comprise of GI pipes to Middle East, USA and Europe as the production of galvanized pipes in these regions is low. Square and Rectangular hollow sections (manufactured using the traditional technology) on the other hand find limited acceptance in the export markets because of the poor quality. However, now that APL has adopted the Direct Forming Technology (DFT) to manufacture superior quality hollow sections (creates a level playing field vis-a-vis international players), it expects significant demand particularly from Europe and USA. Reiterating the optimism, the management also indicated that its trial orders to Europe elicited positive response from clients.
- 9) **OEM Sales to provide a boost:** Currently direct sales to OEMs and large projects contribute to ~3% of the total volumes for APL as the company until now has largely relied on the distributor/dealer network to expand its retail customer base. Direct sales at present are majorly that of GI/GP pipes to solar panel manufacturers and large residential projects. The contribution, however, is expected to grow to over 10% as the company aims to actively start dealing directly with customers with the proposition of providing better products as well as support and service.

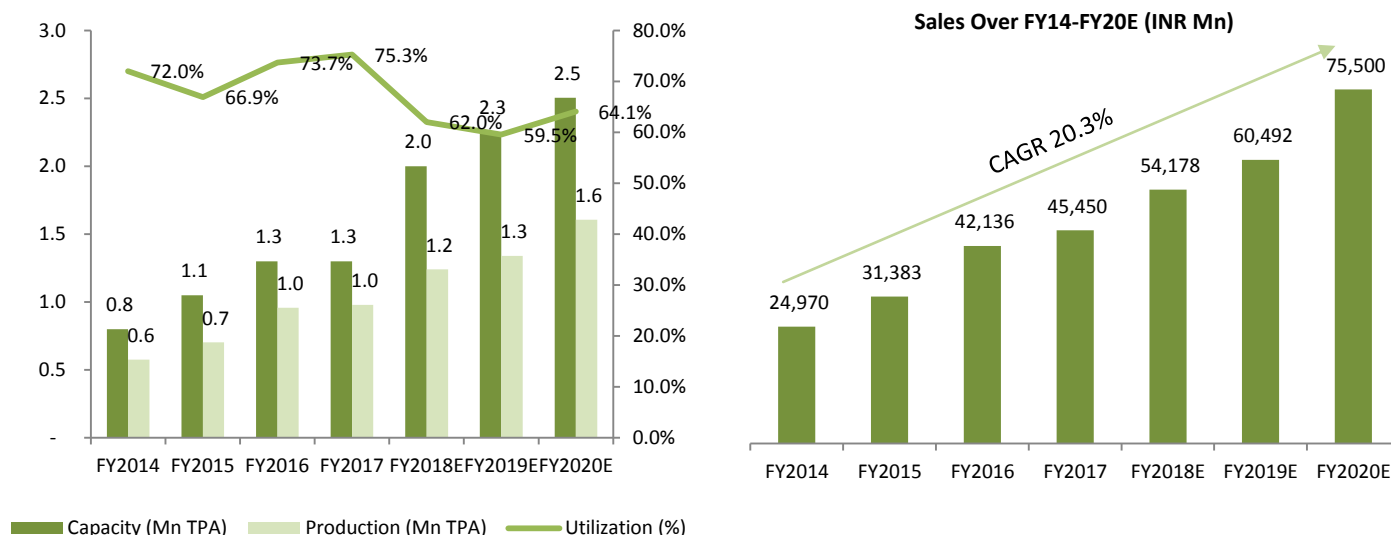
The adoption of DFT technology and the ability to service small and customized orders on the back of it would throw open various opportunities across Truck & Bus body parts, gym equipment and solar mounting systems thus helping it tap the market of OEMs. Another area of focus for the management has been to ramp up the OEM penetration by tapping Solar system manufacturers. Its strategic partnership with NEXTracker Inc., a leading solar tracking company to supply GP pipes for manufacturing a structural component of its solar tracking systems in India is a step towards entering the renewable energy market which has a huge untapped potential.

Financial Commentary:

1) Volume CAGR ~18.5% over FY17-FY20E to drive topline

APL management has been aggressive in its capacity expansion and marketing strategies. In addition, the shift from unorganized producers to organized ones like APL Apollo has led the company to report a volume CAGR of +36% during FY06-17 (cumulative 9mn tones). With its greenfield plant at Raipur, the company will cater to new geographies in the Central and Eastern Indian regions. Besides, addition of 8 lines of DFT across its plant augurs well for its volume growth. We estimate the company to clock a volume CAGR of ~18.5% over FY17-FY20E. Consequently, we estimate APL Apollo to report CAGR ~24.6% Revenues over FY17-FY20E largely driven by volume growth, as any rise or fall in RM prices is a pass through to its clients. Thus, we believe, quality of topline growth will be better if driven by volumes.

Exhibit 14: Volume and Revenue Growth:



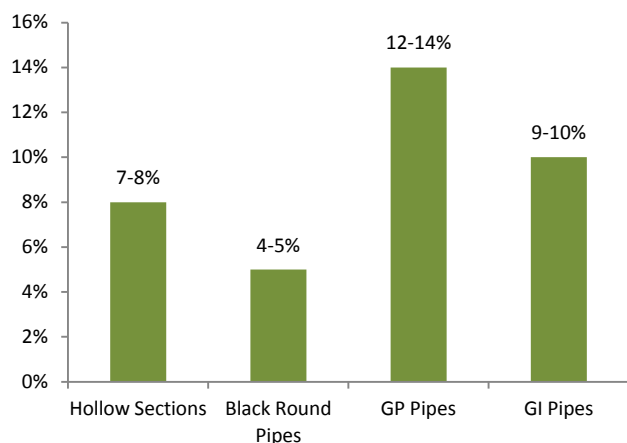
Source: Company, SMC Institutional Research

2) Better product mix, high volume growth to drive EBITDA/tonne

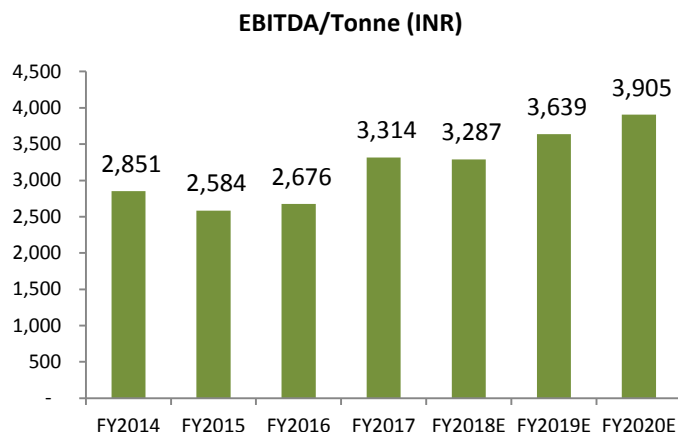
A better metric to assess profitability is EBITDA/ton as APL Apollo's product is into business of conversion of steel to finished goods. Thus prices of steel (HR Coils) a key RM are prone to fluctuation in the global market. Over the past 4 fiscal years, EBITDA/ton has witnessed a marked improvement from Rs. 2,800/ton in FY14 to Rs. 3,300/ton in FY17. This improvement is led by better product mix (increasing contribution from high margin GI/GP Pipes, Hollow Sections and reducing contribution of Black Pipes). A conscious strategy to shift from low margin Black Pipes to higher margin GI/GP pipes too would EBITDA/ton improvement. Looking forward until FY20E, we remain positive on the company's margin sustenance largely due to: 1) introduction of DFT which shall provide an edge to APL Apollo in the medium to long term (though short term focus upto FY18E is on growing volumes); 2) higher contribution from Value Added Products; 3) brand awareness amongst end customers to allow pricing power vis-à-vis peers. Further, with improving utilization operating leverage too will aid EBITDA Margin performance going ahead.

Exhibit 15: Improving margin profile

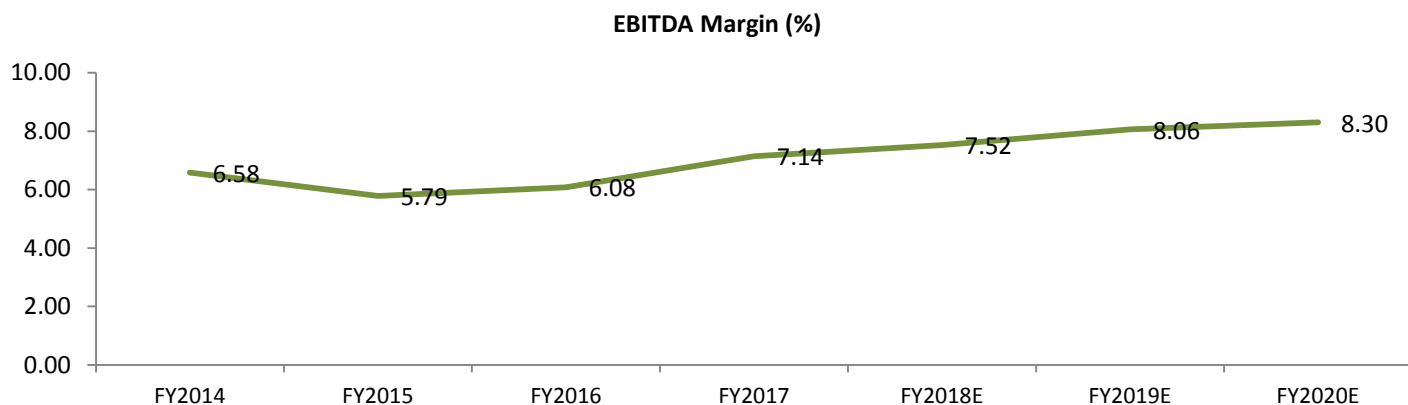
Conscious shift to higher margin products....



....should lead higher EBITDA/Tonne



....leading to improving EBITDA Margins

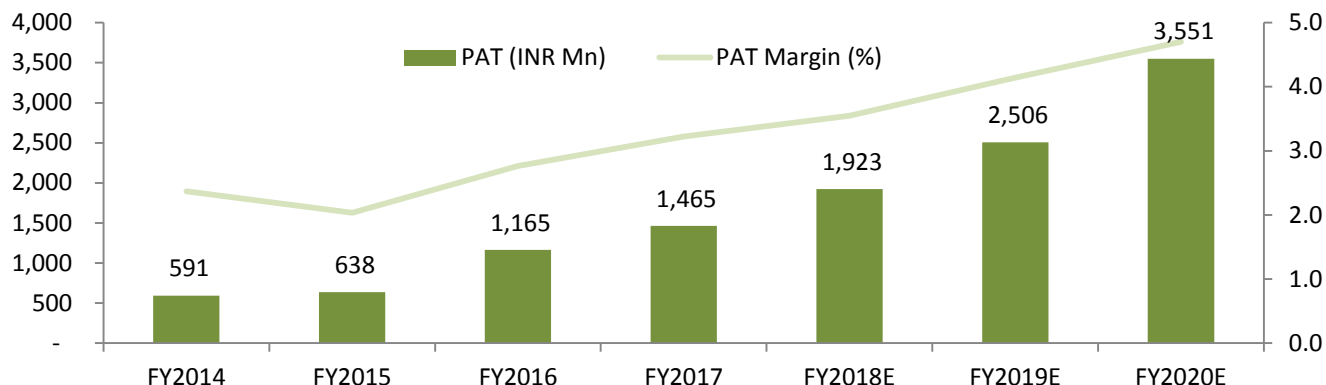


Source: Company, SMC Institutional Research

3) Earnings CAGR of 30% over FY17-20E

APL recorded a profit CAGR of 21% during FY13-17 as a part of the operating profit was eaten away largely by interest cost. As the company will be done with major capex by FY18 and start generating free cash flows from FY19E, we expect it to record a profit CAGR of 30% during FY17-20E to INR 3,551Mn.

Exhibit 16: Leading to Bottom-line growth

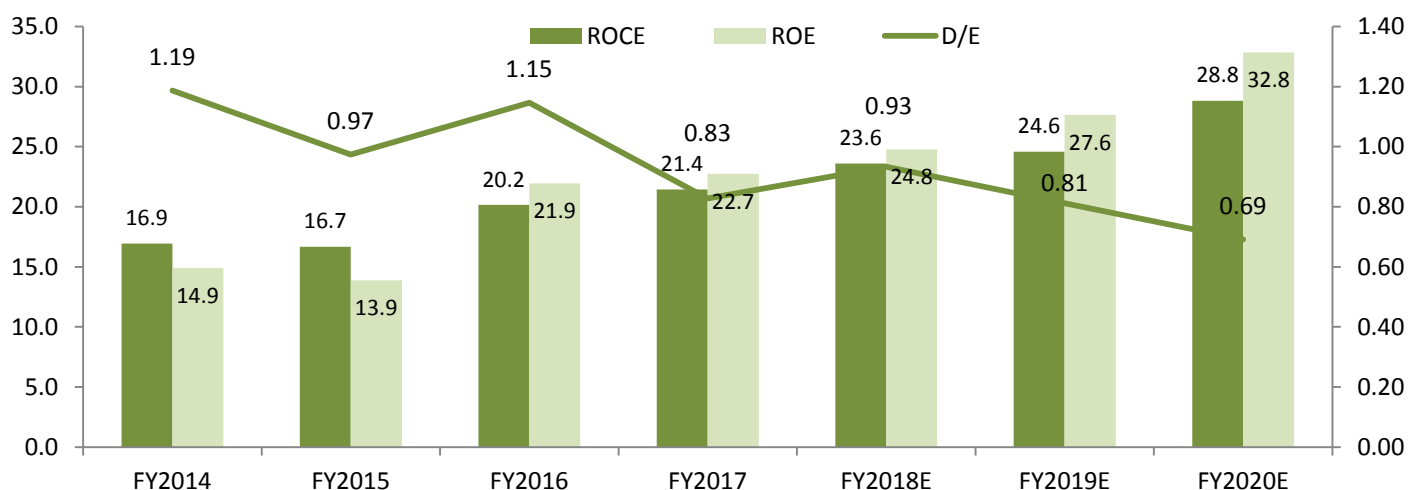


Source: Company, SMC Institutional Research

4) Strong balance sheet; may deleverage further. Higher profitability to improve Return Ratios

APL has maintained strong balance sheet despite aggressive growth in capacity creation. Its Net Debt-Equity ratio remained in the range of 0.9-0.83x from FY13-FY17. With improvement in cash flows, it may further deleverage its balance sheet in the next three years. We expect the Net Debt-Equity ratio to go down to 0.76x in FY20E from 0.83x in FY16. However, we do not rule out any possibility of inorganic growth or further greenfield expansion which may not lead to lowering its debt.

Exhibit 17: Ultimately better Return Ratios



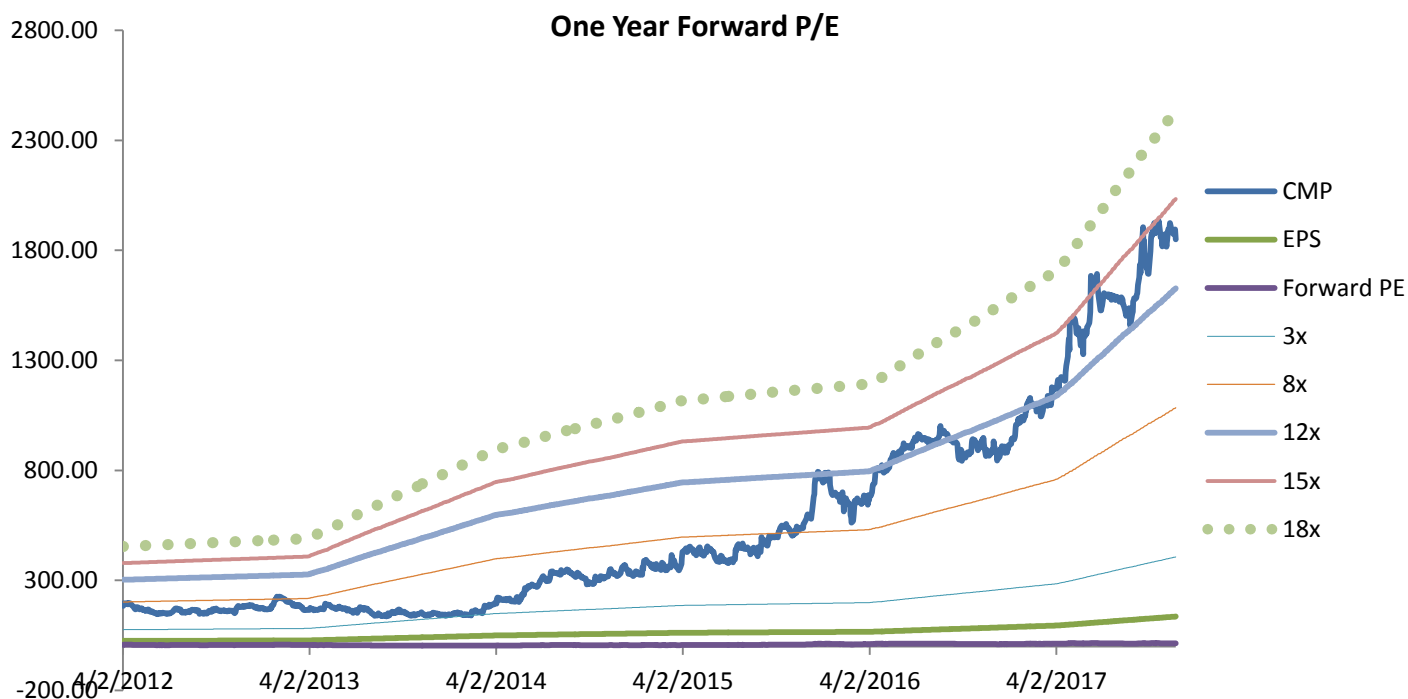
Source: Company, SMC Institutional Research

Outlook & Valuations

APL Apollo is a leading player of ERW Steel Tubes and Pipes in India with a 12% market share making it a compelling investment proposition. We reason it owing to factors like largest capacity of 2MTPA by FY18 in a 7MTPA industry size, first mover in bringing the best of global technologies to India which is incomparable to peers, launch of innovative, patented and value added products, thrust on OEMs and Exports to de-risk its business model and more importantly its widespread and deep distribution network in Tier 2 and Tier 3 regions which is similar to some of the building material companies makes us believers of APL Apollo's "tubes the very reason for growth" argument.

We thus believe the company is expected to post a Revenue/EBITDA/Earnings CAGR of 18.4%/24.5%/34.3% respectively over FY17-FY20E driven by robust demand, higher volumes with capacity additions, improved profitability and lower interest costs. At CMP of Rs. 1,874 stock trades at 12.4x for FY20E, despite having reported an earnings CAGR in excess of 35% over FY14-FY17 period and consistent ROE improvement to 23% in FY17 over FY14 ROE of 15%. We expect, APL to clock ROEs in excess of 25% over FY18E/FY20E. **We initiate coverage on APL Apollo Tubes with a "BUY" rating and a target price of Rs. 2,411 per share over 12 months resulting in a 29% upside from current levels.**

Exhibit 18: Reasonable Valuations



Source: Company, SMC Institutional Research

Risk Factors

1) Volatility in HR Coil (HRC) prices may impact profitability:

As the raw material cost (majorly HRC and Zinc) forms ~85% of total sales, product demand and margins are directly affected due to volatility in steel prices. Increase in prices may affect demand as consumers can defer/ alternate their purchases whereas sharp decline in steel prices may lead to inventory loss. At times, the company may have to bear cost burden as price hikes could decrease the product demand due to intense competition and fragmented nature of industry. Further, RM price volatility could lead to pressure on its operating margins and thereby profitability. However, owing to GST implementation, the possibility of intense competition from unorganized players could drastically reduce thus allowing APL Apollo to enjoy a good relationship with customers.

2) Relatively lower entry barriers given the commodity nature of product

Although, APL is a market leader with 12% share in the ERW industry, the fragmented nature of this industry could cause short term competitive challenges for the company due to lower entry barriers. Lower capex requirements, minimum usage of technology (standardized products) and high asset turnover attracts large number of players in a fast growing economy like India. However, to mitigate the challenges arising from lower entry barriers, APL Apollo Tubes has ensured its market leadership is not affected due to its wide-spread and a well-structured distribution network, creation of a strong brand and innovative patented product manufacturing with the help of latest technological implementations.

3) Delay in capacity expansion plans could impact volumes and value growth

While, in the past APL Apollo has expanded capacity on-time in the past, any delay in capacity expansion going forward could impact its delivery timelines and thereby cause deterioration of working capital cycle (rising costs and operating overheads). This could also negatively impact its margins and thereby profitability.

Management Bandwidth

Name	Designation	Experience
Mr. Sanjay Gupta	Executive Chairman	Founder & Promoter of APL Apollo Tubes since inception. Has a diverse experience across the steel industry segments of over 20 years. Instrumental in driving APL towards the growth path. He spearheads the company in strategic road map and formulating business plans
Mr. Ashok Gupta	Managing Director	A steel industry veteran with over 30 years of experience in the industry. He has worked in various senior managerial positions at companies like SAIL, Bhushan Steel, LN Mittal (African Continent), Jindal etc. A Master's in Science (Physics) and masters in management from AIMA
Mr. Vinay Gupta	Director	He has over 18 years of experience in exports and international market. He possesses in-depth knowledge of manufacturing and trading pipes, tubes, sheets and other steel products. He has been specifically assigned with the development of pre-galvanized business.
Mr. Deepak Goyal	Chief Financial Officer	Chartered Accountant by profession, he has been a CFO of the company since February 2015 prior to which he was the General Manager Accounts

Financial Details

Profit & Loss Statement (INR Mn)

Particulars	FY17	FY18E	FY19E	FY20E
Total Sales	45,450	54,178	60,492	75,500
Total Raw Materials	38,005	45,011	49,930	61,910
COGS	39,154	46,257	51,442	63,873
EBITDA	3,244	4,075	4,876	6,267
Depreciation	512	597	673	753
Amortization	-	-	-	-
Interest & Finance charges	683	839	808	775
Other Income	38	120	218	378
Extraordinary items	-	-	-	-
EBT (as reported)	2,086	2,759	3,613	5,116
Tax	627	842	1,102	1,560
PAT	1,459	1,918	2,511	3,556
Min. Int.	-	-	-	-
Share in gain/loss of assoc.	-	-	-	-
RPAT	1,459	1,918	2,511	3,556
Extraordinaries adj.	(6)	(5)	5	5
APAT	1,465	1,923	2,506	3,551

Source: Company, SMC Institutional Research

Balance Sheet (INR Mn)

Particulars	FY17	FY18E	FY19E	FY20E
Equity Share Capital	236	236	236	236
Reserves	6,967	8,086	9,577	11,575
Net worth	7,203	8,322	9,813	11,811
Total loans	5,962	7,762	7,962	8,162
Deferred tax liability (Net)	905	974	1,064	1,192
Capital Employed	14,152	17,200	19,047	21,484
Gross Block	8,747	9,947	10,947	11,947
Depreciation	1,402	1,999	2,672	3,425
Net block	7,345	7,948	8,275	8,522
CWIP	1,224	1,260	1,241	1,195
Investments	127	192	258	378
Inventories	4,696	6,091	6,558	7,875
Sundry debtors	2,952	3,136	3,574	4,551
Cash and bank	17	277	867	890
Loans and advances	1,344	1,754	2,129	2,869
Total Current assets	9,008	11,258	13,128	16,185
Total Current liabilities	4,348	4,450	5,013	6,305
Net Current assets	4,660	6,808	8,114	9,880
Capital Deployed	14,152	17,200	19,047	21,484

Source: Company, SMC Institutional Research

Cash Flow (INR Mn)

Particulars	FY17	FY18E	FY19E	FY20E
PAT	638	1,006	1,459	1,918
Depreciation & Amortization	298	344	597	673
Incr/(Decr) in Deferred Tax Liability	114	46	69	90
(Incr)/Decr in Working Capital	(2,206)	737	(1,887)	(716)
(Incr)/Decr in Mis. Expense not written off	-	-	-	-
Cash Flow from Operating	(788)	2,586	696	2,558
(Incr)/ Decr in Gross PP&E	(819)	(1,027)	(1,200)	(1,000)
(Incr)/Decr In Work in Progress	(80)	(904)	(35)	19
(Incr)/Decr In Investments	59	4	(64)	(67)
(Incr)/Decr in Other Non-Current Assets	30	(201)	(198)	(166)
Cash Flow from Investing	(810)	(2,129)	(1,498)	(1,214)
(Decr)/Incr in Debt	1,705	(522)	1,860	266
(Decr)/Incr in Share Capital	-	2	-	-
(Decr)/Incr in Other reserves	(724)	(1,119)	(1,491)	-
Dividend	(281)	(340)	(426)	(513)
Cash Flow from Financing	1,424	(454)	1,061	(754)
Incr/(Decr) in Balance Sheet Cash	(175)	3	260	591
Cash at the Start of the Year	14	17	277	867
Cash at the End of the Year	17	277	867	890

Source: Company, SMC Institutional Research

Key ratios

Particulars	FY17	FY18E	FY19E	FY20E
Growth (%)				
Total Sales	7.9	19.2	11.7	24.8
EBITDA	26.6	25.6	19.7	28.5
APAT	25.7	31.3	30.3	41.7
Profitability (%)				
EBITDA Margin	7.1	7.5	8.1	8.3
Adj. Net Profit Margin	3.2	3.5	4.1	4.7
ROCE	21.4	23.6	24.6	28.8
ROE	22.7	24.8	27.6	32.8
Per Share Data (Rs.)				
AEPS	62.1	81.5	106.2	150.5
Reported CEPS	85.5	109.5	138.8	188.1
BVPS	305.3	352.8	416.0	500.7
Valuations (x)				
PER (x)	30.2	23	17.6	12.4
PEG (x)	1.2	0.7	0.5	0.3
P/BV (x)	6.1	5.3	4.5	3.7
EV/EBITDA (x)	15.5	12.8	10.7	8.4
EV/Net Sales (x)	1.1	1.0	0.9	0.7
Dividend Yield (%)	0.6	0.8	0.9	1.1
Turnover days				
Debtor Days	20.6	20.5	20.2	19.6
Payable Days	36.5	34.7	33.5	32.3
Gearing Ratio				
D/E	0.83	0.93	0.81	0.69

Source: Company, SMC Institutional Research

Key to ratings

Ratings	Definition
Buy	ESR is greater than EMR + 15%
Accumulate/ Hold	ESR falls between EMR + 5% and EMR + 15%
Sell	ESR is lesser than EMR - 5%

Notes:

ESR = Expected Security Return

EMR = Expected Market Return, defined as 1 year domestic yield + 5% (as a proxy for market risk premium)



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