APL Apollo Tubes Ltd.

BUY

DFT expansion key for earnings growth

11 Mar. 2017

APL Apollo Tubes Ltd. (APL) is one of the leading manufacturers of ERW pipes in India with a manufacturing capacity of 1.3mn tonnes. Its nearest competitor is nearly half the size of it. Out of the 1.3mn tonnes, galvanized (GI) and pre-galvanized (GP) pipe capacity is 0.12mn tonnes and 0.2mn tonnes, respectively. ERW pipes and structures find application across various industries such as a construction, infrastructure projects, automobiles, consumer goods, residential and agriculture etc.

Investment Rationale: (Page: 9-12)

- Dominant pan-India player in the ERW pipe industry
- DFT = Capex + Technology Disruption
- Further strengthening its pan-India presence
- Expanded installed capacity to aid volume growth
- Structure products demand drivers intact
- OEM and exports business will help in de-risking the business
- Benefits from demonetization and GST
- Massive branding exercise bodes well for the APL brand

Risk and Concerns: (Page: 15)

- Subdued economic recovery post DeMo
- Poor acceptance of DFT based products
- Increase in competition from existing players
- Volatility in the raw material prices

Valuation: (Page: 17)

- APL has all the required parameters needed for a good company. It is the market leader in terms of installed capacity and sales volume. Besides this, it is one of the efficient players in the ERW pipe industry, largely benefiting from its pan-India presence and economics of scale operations.
- The company has been consistently paying dividends with pay out in the range of 11-20% over the last three years.
- At the CMP of Rs. 1,100.2, APL's share is trading at TTM P/E multiple of 19.6x as against the peer average of 19.8x. Additionally, it is trading at a P/BVPS and EV/EBITDA multiple of 4x and 9.3x, respectively as compared to the peer average of 1.9x and 8.9x. However, its fixed asset turnover ratio, RoE and RoCE are significantly higher as compared to its peers. We are of the opinion that the market has not factored in its competitive advantage and the benefits arising from the adaptation of DFT project.

Based on EV/EBITDA multiple of 7.5x to FY19E EBITDA, we arrive at a target price of Rs. 1,436.5 per share, translating into a potential gain of 30.6%. Thus we recommend a **"BUY"** rating on the stock.

Rating Matrix	
CMP (Rs.)	1,100.2
MCAP (Rs. mn)	25,851
Rating	Buy
Potential price (Rs.)	1,436.5
Upside potential	30.6%
52 week H/L (Rs.)	638.3 / 1,144
Investment horizon	18 Months
Face value (Rs.)	10
Category	Mid Cap
Sector	Iron & Steel Products

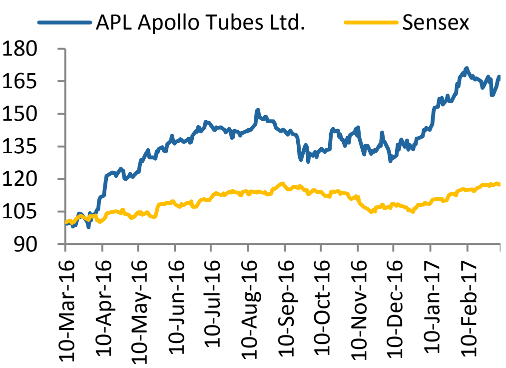
Shareholding Pattern as on 31st Dec. 2016

Particulars	Dec-16	Sep-16	Jun-16	Mar-16
Promoters	38.8%	38.8%	40.6%	40.6%
FIIs	0.5%	0.6%	0.1%	0.1%
DIIs	17.5%	17.3%	16.9%	16.9%
Non institutions	43.2%	43.3%	42.4%	42.4%

Financial Snapshot (Rs. bn)

Projections	FY14	FY15	FY16	FY17	FY18	FY19
Revenue	25.5	30.4	42.1	43.4	54.7	63.4
EBITDA	1.6	1.8	2.8	3.2	4.1	5.1
Adjusted PAT	0.6	0.6	1.3	1.4	1.9	2.6
EBITDA (%)	6.5%	6.0%	6.7%	7.4%	7.6%	8.1%
PAT (%)	2.3%	2.1%	3.0%	3.1%	3.5%	4.0%
EPS	25.2	27.1	53.6	57.6	80.4	108.5
BVPS	181.0	210.7	241.5	290.4	358.7	451.0
RoNW (%)	13.9%	12.9%	22.2%	19.8%	22.4%	24.1%
RoCE (%)	24.0%	22.6%	29.2%	27.9%	31.9%	34.8%
P/E				19.1	13.7	10.1
P / BVPS				3.8	3.1	2.4
EV/EBIDTA				9.9	7.6	6.0

Relative Capital Market Strength



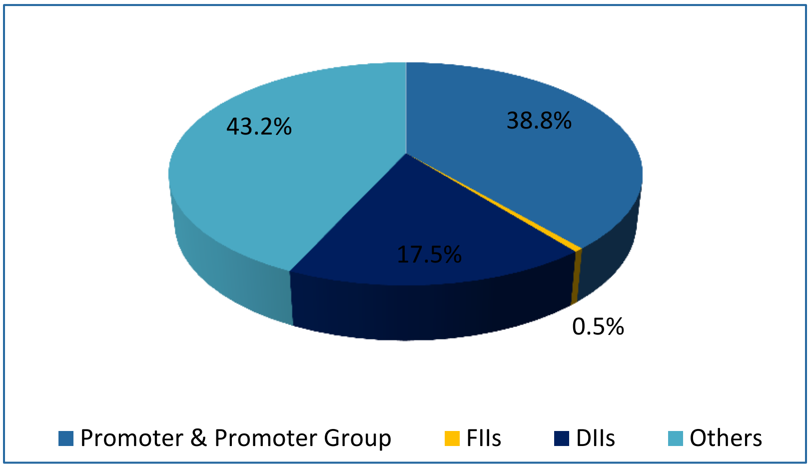
Rajnath Yadav | Board line: +91 22 6707 9999; Ext. 912 | rajnath.yadav@choiceindia.com

Management Team

Name	Designation
Mr. Sanjay Gupta	Executive Chairman
Mr. Ashok Kumar Gupta	Managing Director
Mr. Sharad Mahendra	Director
Mr. Romi Sehgal	Director
Mr. Abhilash Lal	Independent Director
Mr. Virendra Singh Jain	Independent Director
Mr. Anil Kumar Bansal	Independent Director
Ms. Neeru Abrol	Independent Woman Director
Mr. Deepak Goyal	Chief Financial Officer
Mr. Adhish Swaroop	Company Secretary & Compliance Officer

Source: Choice Broking Research

Shareholding Pattern (as on 31st Dec. 2016)



Source: Choice Broking Research

Shareholders more than 1% (as on 31st Dec. 2016)

Share Holder Name	Stake (%)
APL Infrastructure Pvt. Ltd.	34.0%
PIIN Kitara	16.3%
IDFC Premier Equity Fund	6.5%
DSP Blackrock Investment Manager	5.9%
HDFC Asset Management Co. Ltd.	4.9%
Ashok Kumar Gupta	4.7%
Emblem FII	3.1%
Sampat Sameer Mahendra	2.4%
Kacholia Ashish	2.3%
Suresh Kumar Agarwal	2.3%

Source: Choice Broking Research

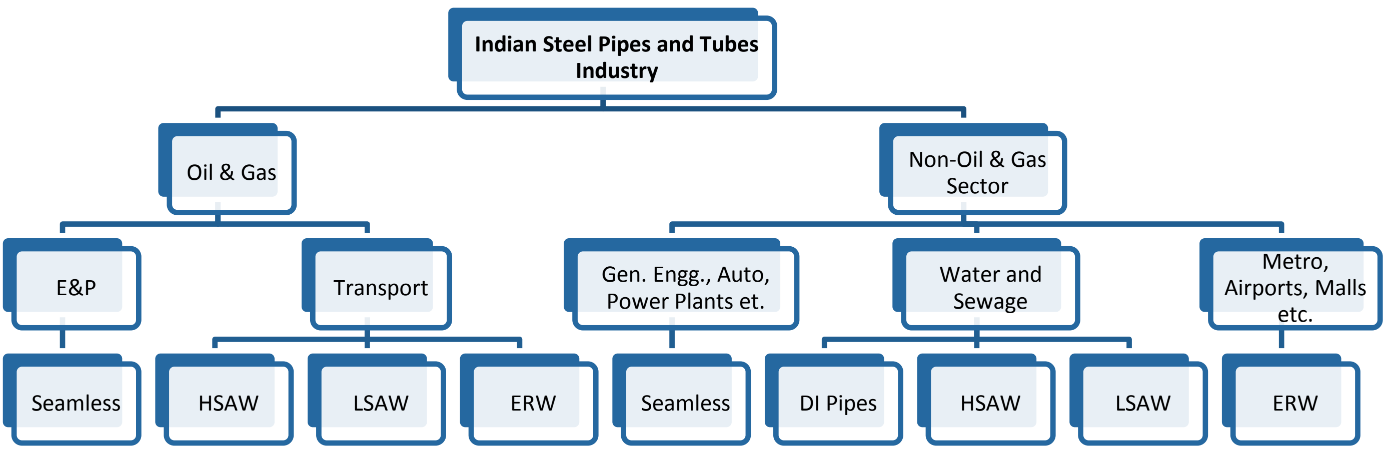
Indian Steel Pipes and Tubes Industry:

The Indian pipe industry is categorized into oil & gas and non-oil & gas sector. Based on the usage and application, there are basically three types of steel pipe i.e. submerged arc welded (SAW) pipes, seamless pipes and electric resistance welded (ERW) pipes.

SAW pipes: These pipes have a large diameter and are used for the transportation in the oil & gas and water industry. SAW pipes are formed by the process a called submerged arch welding. There are two types of SAW pipes: longitudinal SAW (LSAW) and helical SAW (HSAW). LSAW pipes are formed by bending the steel plates and subsequently welding longitudinally (internally and externally) along the seam to form a pipe. Whereas, HSAW are formed from the hot rolled coils (HRC) and are subsequently welded internally and externally to form HSAW pipes.

Seamless pipes: These pipes are drawn by creating a hollow shell in the solid billet. Since there is no welding required, these pipes are considered to be stronger and more reliable withstanding high pressures. Seamless pipes mainly find application in the oil & gas exploration activities and engineering sectors

ERW pipes: These pipes are formed by folding the HRC and performing continuous welding in a single row. ERW pipes are small to medium diameter pipes with broad applications in the oil & gas, construction and automobiles sectors among others.



Source: Choice Broking Research

Product Summary	LSAW	HSAW	ERW	Seamless
Size	16" to 50" diameter	18" to 120 diameter	0.5" to 22 diameter	0.5" to 14 diameter
Key Raw Material Manufacturing Process	Steel Plates Longitudunally Submerged arc welding of steel plates	HR Coils Spirally Welding HR Coils	HR Coils Hot Rolled steel coils using electrical Resistance welding Process	Steel Billets Piercing ingots/ billets of steel at high temperatures
Key Difference	High Pressure Conditions	Low pressure conditions thickness and grade	For the same size and shape, cheapest to manufacture High Flexibility to build different shapes & sizes	High pressure
	Demand is directly Related to oil & Gas Sector	Demand is directly related to Oil & Gas sector, water and Sanitation sector	Suitable for branch line in oil & gas distribution	Application in oil and non oil related industries
Application	Oil & Gas Transportation	Oil & Gas/ Water Transportation	Oil & Gas/ Water Distribution, Metros, Airport, Malls, fabrication, structural sections, windmills, solar plants	Petroleum, Exploration General Engg, Boilers
Key Players	Jindal Saw, Welspun Crop, Man Industries	PSL, Jindal Saw, Welspun Crop, Man Industries	APL Apollo, Surya Roshni, Tata Pipes, Jindal Hissar, Bhushan Steel	Jindal Saw, Maharashtra Seamless, Ratnamani

Source: Choice Broking Research

Indian Steel Pipes and Tubes Industry (Contd…):

As of FY16 end, India is among the top three manufacturer hub for steel tube and pipe manufacturer in the world, with a capacity of around 10mn tonnes. ERW pipe represents the largest segment in the steel pipes and tubes market. The prime reason behind the manufacturing hub position is mainly the low cost production, quality production and geographic advantage.

The demand for seamless tubes mainly depends on the oil & gas exploration activities, which in turn depend upon crude prices. Higher the crude prices, higher the profits for the oil & gas companies and thus higher exploration activities. The last 2-3 years was characterized by lower crude price and thus there were lower exploration activities, thereby leading to lower demand of seamless pipes. With increasing crude prices, the demand of seamless pipes will also increase. The demand of SAW pipes was also not encouraging, as it finds application in the transportation of oil, gas, slurry, water etc. On the other hand, due to wide applications, the ERW pipe industry has managed to grow at 7-8% in the last 3-4 years.

ERW Pipe Industry in India: Out of the 10mn tonnes of the Indian steel pipe and tube industry, ERW pipes and tubes form the largest segment with an estimated capacity of around 7mn tonnes. The ERW market is highly fragmented with around 30-40% of the market belonging to un-organized players. Major organized players in the ERW pipes are mentioned below:

- APL Apollo Tubes Ltd. (APL)
- Tata Pipes Ltd.
- Jindal Group (Maharashtra Seamless Ltd., Jindal Pipes, Jindal Industries Ltd.)
- Surya Roshini Ltd.
- Ratnamani Metals & Tubes Ltd.
- Swastik Pipe
- Rama Steel Tubes Ltd.
- Hi-Tech Pipes Ltd.
- Goodluck India Ltd.
- Welspun Corp

ERW steel pipe industry is largely dependent on the investment across sectors like residential and non-residential construction, urbanization, consumer goods manufacturer, infrastructure, automobiles and agriculture spending etc. And that is the main reason why the ERW pipe industry has maintained a positive growth rate despite the slowdown in the economy in the past.

The investment in the infrastructure projects will be the demand drivers for the ERW steel pipe and tube market in India. According to Global Industry Analysts Inc. report dated July 2016, the global market of ERW pipes is estimated at 86.5mn tonnes by 2022. Asia Pacific region is expected to be the dominant force with 60.8% market share. Moreover, the region is also forecasted to lead the projected growth rate with 7.1% CAGR. India will be the fastest growing market mainly due the emphasis on various initiatives such as Smart City project, improvement and expansion in the water and gas distribution system, low housing schemes, improving transportation system, expansion on the electricity capacity (namely solar capacity) and creation of modern infrastructures like malls, airports etc.. Below are the detailed demand drives for the ERW pipes in India:

Construction & Infrastructure: Steel pipes find a significant usage in the construction industry, where it is used in a variety of applications such as support structure, conduit, fencing, railing, etc. India needs around Rs. 65tn investment in the infrastructure over the 12th five year plan. Infrastructure expansion is needed in all areas such as roads, ports, airports, metro rails, solar power plants etc. These are likely to create increased construction demand and this coupled with “Make in India” initiatives, which will boost the demand of ERW steel pipes in India.

Indian Steel Pipes and Tubes Industry (Contd…):

Smart Cities and AMRUT Program: The government of India has planned to construct 100 smart cities by 2020, whereby it has allotted Rs. 1bn for each smart city for a period of five years. The smart cities mission will also look at optimizing basic core infrastructure services such as clean drinking water supply, affordable housing etc. Further, in order to provide basic services (e.g. water supply, sewerage, urban transport) to households in both urban and rural areas, the government has come out with a program named "Atal Mission for Rejuvenation and Urban Transformation" (AMRUT). One of the key purposes of this program is to provide each and every household with assured water supply and sewerage connection. The total outlay for AMRUT is Rs. 500bn for five years from FY16 to FY20. The advantage of ERW pipes and tube in the household application is that it is cost effective. Thus the increased penetration of ERW pipes and replacement of the wood with steel pipes will increase the demand of ERW pipes and tube.

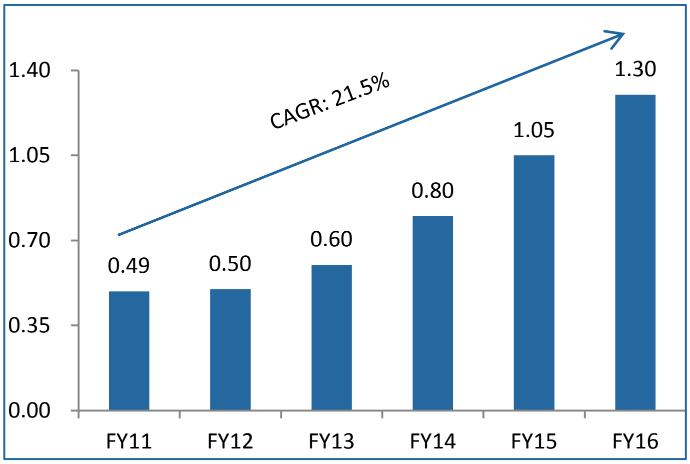
Implementation of GST: As mentioned, the un-organized players accounts for 30-40% of the total ERW pipe market. With the implementation of the GST, these players will have the only option to move to the organized market. Being a producer of low quality product and at higher cost, most of the unorganized players will not be able to sustain the competition from the organized market. Thus it is very much likely that most of these players will vanish over a period, which will be beneficial for the organized players.

Company Introduction:

APL Apollo Tubes Ltd. (APL) is one of the leading manufacturers of ERW pipes in India with a manufacturing capacity of 1.3mn tonnes. Its nearest competitor is nearly half the size of it. Out of the 1.3mn tonnes, galvanized (GI) and pre-galvanized (GP) pipe capacity is 0.12mn tonnes and 0.2mn tonnes, respectively.

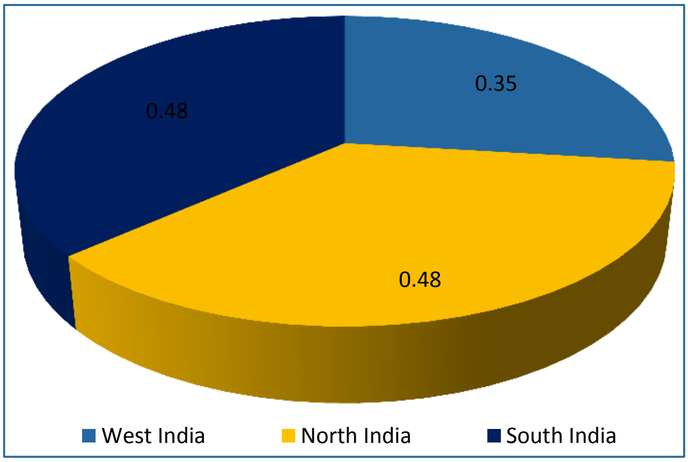
Founded in 1986, with a modest annual ERW pipe facility of 6 tonnes in Uttar Pradesh (UP); over the period through organic and in-organic expansion it has expanded its manufacturing capacity and domestic foot prints. The company strengthened its position in North India by acquiring Apollo Metalex Pvt. Ltd. Additionally, with the acquisition of Shri Lakshmi Metal Udyog Pipes Ltd. in 2008 and Lloyds Line Pipes Ltd. in 2010, the company ventured in the South and West India, respectively. Thus starting with one manufacturing facility, currently it has five manufacturing facilities covering West, North and South India. Over the next one year, it is expected to enter the East India market with the installation of Raipur facility.

Annual Production Capacity (mn tonnes)



Source: Choice Broking Research

Domestic Geographical Capacity Breakup



Source: Choice Broking Research

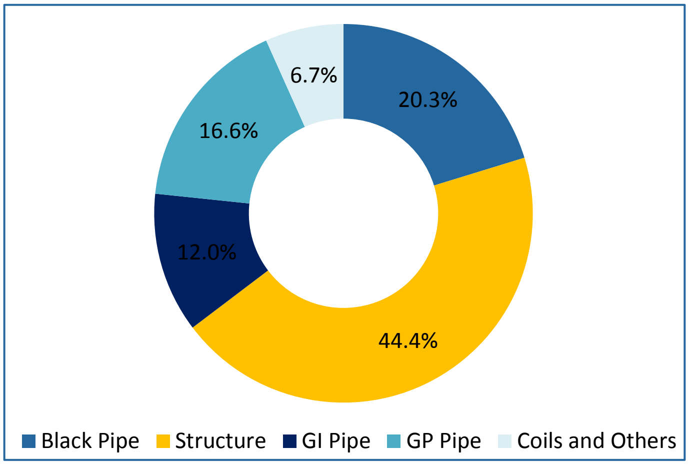
Wide domestic footprint is further boosted by its vast distribution network spread across India. As of 31st Dec. 2016, APL has over 600 direct distributors and 40,000 retailers across 300 cities and towns. Further this network is supported by 26 warehouses.

Source: Choice Broking Research

Company Introduction (Contd…):

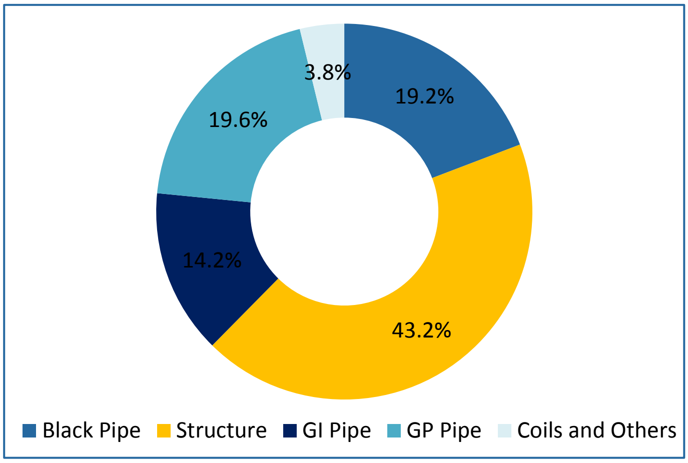
Currently, APL is engaged into the manufacturing of steel tube, pipes and hollow sections and has a diversified product portfolio comprising of over 400+ varieties of ERW steel tubes ranging from 0.5” to 14” (outer dia) with thickness of 0.7-10mm. The company is the pioneer in the GI and GP pipe manufacturing in India. Its product is divided into four categories; black pipe, structures (hollow section), GI pipe and GP pipe. In FY16, structures and black pipe formed around 65% of the sales mix, while the rest was shared by GI and GP pipes. On the revenue front, structures and black pipe generated around 60% of the consolidated revenue, while the rest were contributed by GI and GP pipes.

Sales Volume Breakup in FY16



Source: Choice Broking Research

Product wise Revenue Breakup in FY16



Source: Choice Broking Research

From profitability perspective, GI pipes have a profitability margin of 9-10%, followed by GP pipes with 13-14%, structures with 9-10% and black pipes with 4-5%. The company generates 92% of the sale through its dealers and distribution network, while the exports is close to 6% and sale to original equipment players (OEM) is 1.5-2% only.

Its clientele includes companies from various industrial sectors such as automobiles (including chassis manufacturing), housing, furniture, structural, container making, railway electrification, electric poles, telecommunication, power stations, handling equipment, electrostatic precipitators etc.

APL is the pioneer in adapting latest technology, which helps it in providing quality tubes and pipes to its clients. Previously, it had brought rotary sizing mill technology in India, which helped it in bringing product uniformity and enhanced production process. Currently, it is in the process of installing direct forming technology (DFT) at its existing plant with a capacity of 0.5mn tonnes. The company is setting up eight mills with DFT technology, of which two mills each will be at the existing three facilities, while two mills at the new facility in Raipur. This will be new technology in India, by which APL will be able to meet the structures demand arising mainly from the urban infrastructure projects, solar plants, housing, irrigation etc.

On 25th Jan. 2017, CARE rating has reaffirmed its credit rating of CARE A1+ on the banking facility of Rs. 1,300mn. Moreover it has also reaffirmed its rating of CARE A1+ on the commercial paper facility amounting to Rs. 2,000mn.

Company Introduction (Contd…):

SWOT Analysis:

Strengths:

- Leading manufacturer of ERW pipes in India with a market share of around 13%
- Pioneer in adapting latest technology in the pipe industry in India
- Pan-India manufacturing presence
- Diversified product portfolio comprising of over 400+ varieties of ERW steel tubes
- Markets 80% of the produce via owned distribution network
- Presence in Tier II and III cities
- Industry best profitability margin

Weakness:

- Un-organized players accounts for 30-40% of the total ERW pipe market in India
- Direct sales via the dealers & distribution network form the major portion
- Volatility in key raw material prices

Opportunities:

- Unaddressed exports and OEM market
- First movers advantage in the DFT in India
- Higher infrastructure investment in India
- Consolidation in the pipe industry
- Replacement demand: Increased usage of ERW pipes and structures in place of wood
- No threats from imports

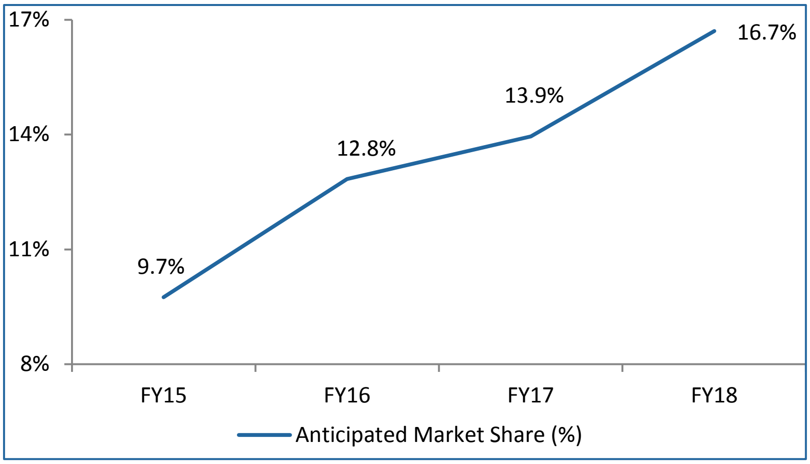
Threats:

- Increased competition
- Huge capacity additions by existing competitors
- Poor acceptance of DFT based products
- Technology redundancy

Investment Rationale:

1) **Dominant pan-India player in the ERW pipe industry:** APL is one of the dominant players in the ERW pipe market in India with a market share of around 13% in FY16. Over the period, through simultaneous increase in the capacity and production levels, it has improved its positioning in the market. With no expected major capacity addition by the competitors, the management has guided a market share of around 20% over the next couple of years. However, we believe the company will be able to increase its market share by around 400bps to 16.7% by FY18.

Anticipated Market Share by FY18



Source: Choice Broking Research

2) **DFT = Capex + Technology Disruption:** APL is a pioneer in adapting the latest technology in the pipe and structure manufacturing industry. It is undertaking a Rs. 1,500-2,000mn brownfield expansion with a capacity of 0.38mn tonnes at its existing facilities with the latest direct forming technology (DFT), which will be used for the manufacturing of the steel structures. Additionally, a new DFT capacity of 0.13mn tonnes is constructed at the Raipur facility, taking the cumulative DFT capacity to 0.5mn tonnes. These expansion projects are likely to be completed by H1 FY18. DFT is new in India and thus is anticipated to be revolutionary in the domestic pipe industry. Below are few of the advantages of the DFT:

- Squares and rectangle structures can be directly made without forming round pipes. Under the current traditional system, squares and rectangle structures are made from the round pipes.
- Structures of different sizes can be made at a short notice. Moreover, the lot size is not a constraint.
- Structures manufactured from DFT will have perfect shape and edges.
- It will enhance APL's ability to manufacture higher thick ness of structures. Currently, it manufactures 6mm thick structures, which will go up to 12mm post DFT.
- The company will have the first movers advantage with a technology protection for the initial three years.
- According to the management, at full capacity, the DFT is likely to generate a revenue of Rs. 20,000mn, thereby providing an asset turnover of 10x.

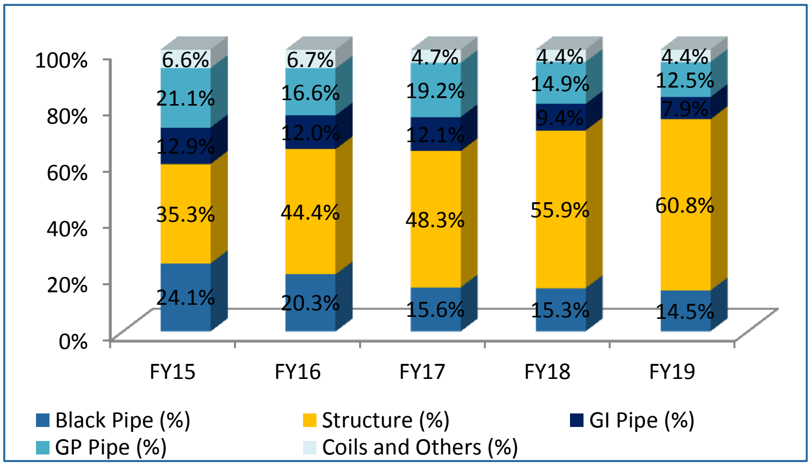
DFT Capacity Expansion Breakup				
	East India (Ongoing Greenfield Expansion)	West India	North India	South India
DFT Capacity Addition (mn tonnes)	0.13	0.13	0.13	0.13

Source: Choice Broking Research

Investment Rationale (Contd…):

Besides the above positives, DFT will speed up the production process, bring more production flexibility and reduce the cost drastically. Additionally, it will increase the structure sales-mix from 44.4% in FY16 to around 60% by FY19. Structure, as a product has a profitability margin of 8-9% as compared to black pipes of 4-5%.

Structure Products Share in the Sales-Mix



Source: Choice Broking Research

3) **Further strengthening its pan-India presence:** Through its manufacturing facilities coupled with the sales & distribution network, APL has presence in the West, North and South India market. East India market is covered by its sales & distribution network. Currently, the company is implementing a Rs. 1,000mn greenfield expansion project at Raipur, Chhattisgarh with a capacity of 0.32mn tonnes. The project is expect to be completed in H1 FY18 and will aid the company in directly serving the East India market.

4) **Expanded installed capacity to aid volume growth:** Since FY16, APL is implementing its "Vision 2020", by which it is proposing to become the largest ERW player in the world with an installed capacity of 2.5mn tonnes. DFT expansion and the greenfield expansion at the Raipur will take the total installed capacity to 2mn tonnes by FY18. Further, the company has planned an inline galvanizing facility and precision tube facility with capacity of 0.1mn tonnes each at Bangalore. Additionally, it has also planned a facility in UAE with a capacity of 0.3mn tonnes, which will cumulatively take the total installed capacity to 2.5mn tonnes by 2020. Total capex requirement is anticipated to be Rs. 5,000mn.

Capacity Expansion Schedule

	Capacity (mn tonnes)	Capex (Rs. mn)
Capacity as on FY16 end	1.3	
Brownfield Expansion (8 Mills with DFT Technology)	0.5	1,500
Greenfield Expansion (Raipur Project)	0.2	1,000
Greenfield Expansion (UAE Project)	0.3	1,500
Greenfield Expansion (Precision Tube Project, Bangalore)	0.1	~ 500
In-Line Galvanizing Plant	0.1	~ 500
Final Capacity Post Rs. 5,000mn CAPEX Plan	**2.5**	**5,000**

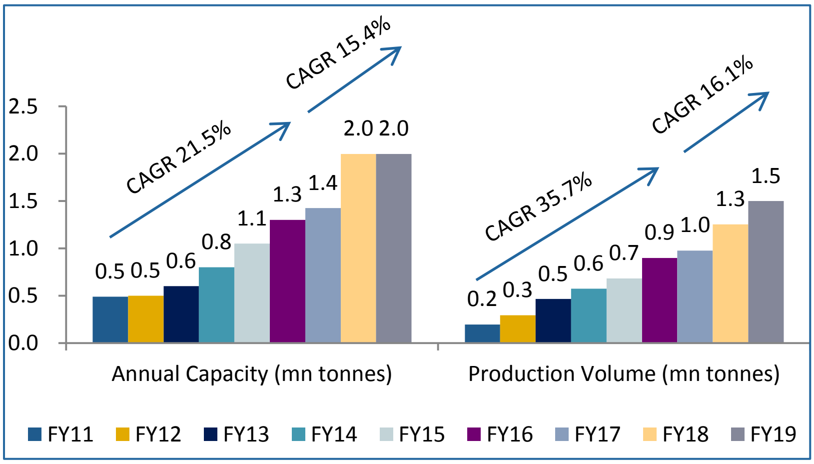
Source: Choice Broking Research

Investment Rationale (Contd…):

Historically, on the back of sustained demand, the company was able to simultaneously increase the production levels and the installed capacities. Over FY11-16, installed capacity and production volume increased by 21.5% and 35.7%, respectively.

The pipe industry has not witnessed lower demand in the past, it has steadily increased by 7-8% CAGR. We are of the opinion that with increasing demand from infrastructure projects and increasing replacement of wood with steel pipe and structures, the industry is expected to grow at higher rate in future. APL will continue to outperform the industry in terms of growth rate with reporting an installed capacity and production volume growth rate of 15.4% and 16.7%, respectively over FY16-19.

Synchronized Increase in the Capacity and Production Volume



Source: Choice Broking Research

5) **Structure products demand drivers intact and is further expected to get a boost:** Steel structures primarily find application in the infrastructure projects (i.e. metros, buildings, airports, ports, prefabricated industries, smart cities projects etc.), used in the construction projects in the form of support structures, fencing, conduit, railings, cranes etc., in automobiles industries for truck & bus body, heavy vehicles etc., energy sector (solar power plants, city gas pipe line, power etc. and in agriculture sector. Because of its varied application across sectors and industries, the structure demand was not impacted in the past, despite the slowdown in the economy. Going forward, with the revival in the economy, policy support from the government and increased penetration of the steel structure in place of wood, we believe that the steel structure will maintain a double digit growth rate going forward. APL being a major player in the steel structure segment and with the early adaption of the DFT, will be able to differentiate is steel structure products and thus will be isolated from the competition. Thus we feel that APL is well positioned to capitalize the opportunities arising from these sectors and industries.

6) **OEM and exports business will help in de-risking the business:** With non-availability of right sized square and rectangle steel structures, OEMs sector till now were relying on the imports and to some extent on the substitutes like other material. Similarly, most of the large sections used in the infrastructure projects are imported due to un-availability in the domestic market. Post the commissioning of the DFT, APL will have a big un-served domestic market. To capitalize the opportunity, the company has identified large consumers, normally OEMs and is marketing its DFT products and the benefits arising from technology coupled with the cost savings. These OEMs have a system of approvals and testing; and once APL gets these approvals, it will be in a position to service them.

   DFT, which is in line with the global standards and is available in the advanced countries like the USA, Europe etc. In future, APL plans to target the international market in big way. Currently, the exports and sales to OEM are in single digit to the overall sales. Post DFT, the company is targeting it to increase to 25% levels by FY18. In Q3 FY17, the sales contribution from exports and OEM has increased to 10% as compared to 6% a year ago. With increasing sales contribution from the OEM and export market, the company would be in a position to de-risk its structural steel business from competition; nevertheless, it will face domestic competition in the black pipe business.

Investment Rationale (Contd…):

7) **Benefits from demonetization and GST:** Un-organized players accounts to 30-40% of the domestic ERW pipe market. With the implementation of the recent demonetization (DeMo) exercise by the government, it is believed that most of the un-organized industries might have been impacted. Moreover, with the implementation of the GST in future, these players will have the only option to move to the organized market. Being a producer of low quality product and at higher cost, most of the unorganized layers will not be able to sustain competition from the organized market. Thus it is very much likely that most of these players will vanish over a period, which will be beneficial for the organized players. APL with its pan-India presence and vast product folio is likely to benefit from the same. These organized players might grab the market vacated by these un-organized players.

8) **Massive branding exercise bodes well for the APL brand:** To promote its new DFT products and other value added products, and to increase its awareness among the consumers, APL is implementing a massive brand exercise with an annual budget of Rs. 200-250mn per year. The company aims to shift its consumers view on it from a commodity product company to a value added product company. It has hired a marketing consultant - Normex Consulting Llc and intends to participate in trade expos, fabricator meets, use signage boards for brand visibility and other focused advertising & brand building initiatives, which will assist it in mitigating the competition and attain a sustainable volume growth in future.

9) **Consistent financial performance over FY11-16 and is expected to continue in future:** On the back of 33.6% CAGR rise in the sales volume over FY11-16, APL reported a 36.2% CAGR increase in the total operating revenue to Rs. 42,121.8mn. Sales volume increased simultaneously with the increase in the installed capacity, which increased by 21.5% CAGR to 1.3mn tonnes in FY16. During the period EBITDA and PAT margin remained in the range of 6-9% and 2-5%, respectively. With the completion of the current investment plan, the company will increase the installed capacity from current 1.3mn tonnes to 2mn tonnes by FY18. Sales volume increase in-line with the capacity and is expected to report a growth of 16.1% CAGR over FY16-19. Consequently, total operating income is anticipated to increase by 14.6% CAGR over the same period to Rs. 63,414.5mn. With higher proportion of niche products in the sales-mix, the company is likely to report a 22.1% CAGR rise in EBITDA with expansion in the margins from 6.7% in FY16 to 8.1% in FY19. Adjusted PAT to increase in line with EBITDA and report a growth of 24.1% CAGR over FY16-19. Moreover PAT margin is expected to expand from 3% in FY16 to 4% in FY19. RoE to improve from 22.2% in FY16 to 24.1% in FY19, while fixed asset turnover to increase from 6x to 7x, over the same period.

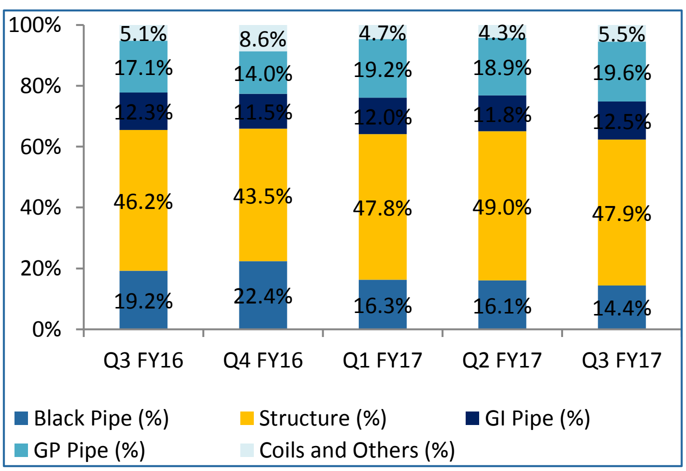
Recent Quarter and Annual Performance Analysis:

Recent Quarter Result Analysis: During Q3 FY17, APL reported 21.2% Y-o-Y rise in total operating income to Rs. 11,461.2mn, which was due to 11.9% and 8.3% increase in blended realization and sales volume, respectively. This quarter was largely affected by the DeMo, as a result of which, the company reported an 18.7% Y-o-Y decline in the black pipe sales volume. Sequentially, the sales volume of steel structure was also impacted, but on Y-o-Y basis, there was a rise of 12.2%. The sales volume of the high margin GI and GP increased by 10% and 24.4% Y-o-Y, respectively. The key reason behind the higher sales volume was that during the DeMo period, the company proactively targeted the exports and the OEM business, thereby leading to a 34% rise in the export sales volume and almost doubling of the OEM sales volume. On realization front, APL benefited from the increased sales realization, mainly on the account of higher international steel prices.

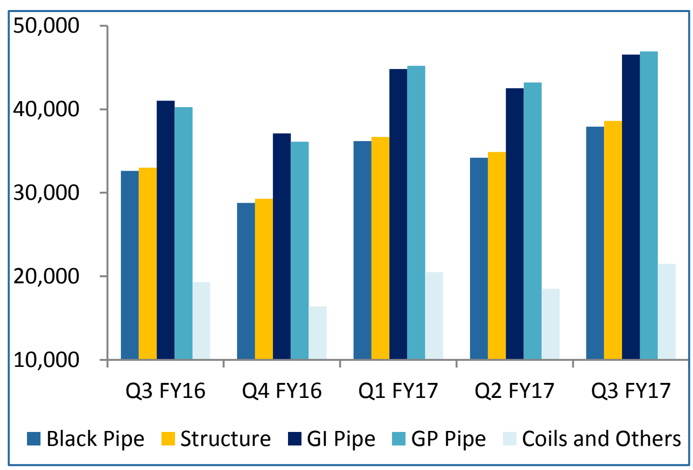
Total operating expenditure increased by 22% Y-o-Y, mainly due to rise in the cost of raw materials, which as a percent of operating income increased by 721bps Y-o-Y to 70.3%. Consequently, Q3 FY17 consolidated EBITDA stood at Rs. 777.3mn (an increase of 10.1% Y-o-Y). EBITDA margin contracted by around 70bps Y-o-Y to 6.8%.

Due to the change in the life of the assets (with effect from Q1 FY17), APL reported 34.6% Y-o-Y rise in the depreciation charges, however, it declined by 34.8% Q-o-Q. Finance expenses declined by 3.9% Y-o-Y, while other income declined by 161.5% Y-o-Y. Moreover, effective tax rate increased by around 5ppts to 37.8%. Accordingly, reported PAT declined by 5.1% Y-o-Y to Rs. 295.6mn. PAT margin contracted by around 70bps to 2.6% in Q3 FY17.

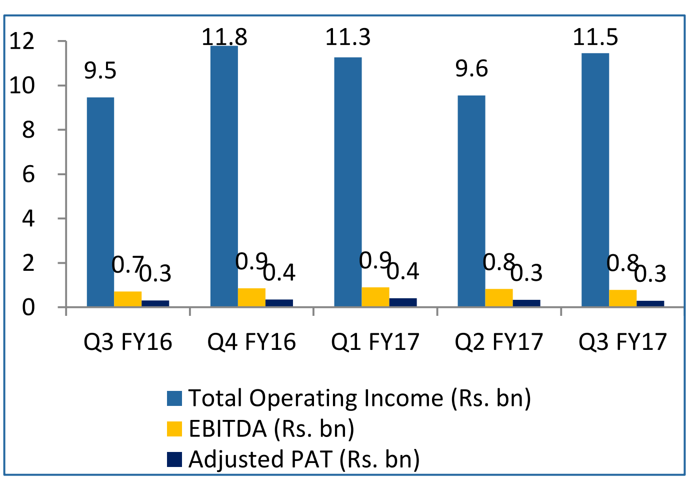
Quarterly Sales Mix



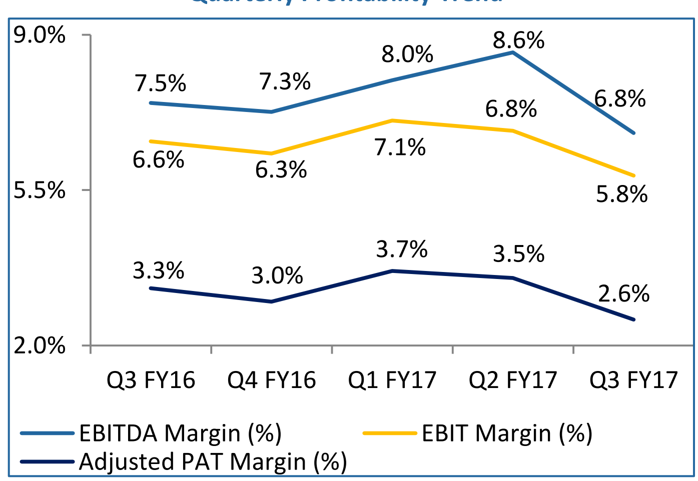
Quarterly Product-Wise Realization



Quarterly Financial Performance



Quarterly Profitability Trend



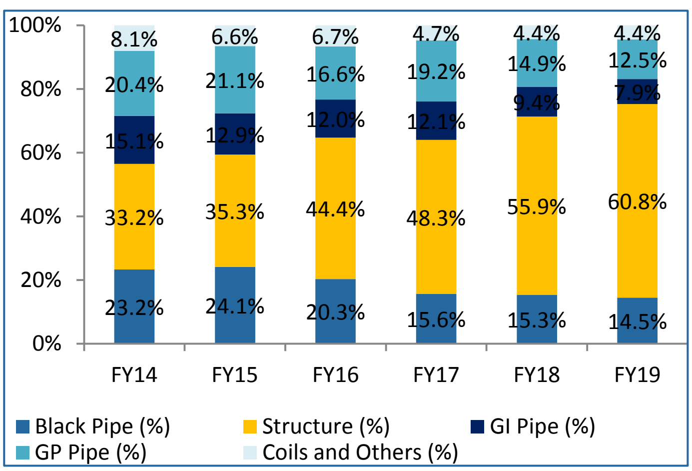
Source: Choice Broking Research

Source: Choice Broking Research

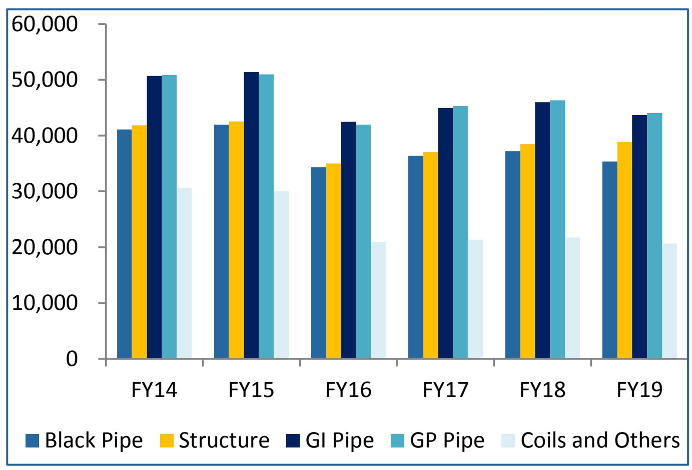
Recent Quarter and Annual Performance Analysis:

Recent Annual Result Analysis: On the back of 36.3% rise in the sales volume, APL reported 36.4% increase in net sales in FY16 to Rs. 41,343.1mn. During the same period blended realization remained flat. Installed capacity stood at 1.3mn tonnes as compared to 1.05mn tonnes in FY15. Sales contribution from the niche products (i.e. steel structures, GI and GP pipes) increased from 69.3% in FY15 to 73% in FY16, while the sales contribution from the black round pipes declined from 24.1% to 20.3%. Revenue from the other operating activities stood at Rs. 778.7mn in FY16 as compared to Rs. 45.7mn in FY15. Consequently, total consolidated operating revenue increased by 38.7% in FY16 to Rs. 42,121.8mn. Total operating expenditure increased (at a relatively lower pace as compared to top-line) by 37.8%, thereby leading to a 53.9% increase in consolidated EBITDA of Rs. 2,818.5mn. EBITDA margin expanded by around 65bps to 6.7% in FY16. Depreciation charge increased by 54.9%, mainly due to the rise in the installed capacity. Financial charges reported a modest growth of 4.6% in FY16. Other income increased by 236%, while effective tax rate increased by over 3.5ppts to 38.3%. Subsequently, adjusted consolidated PAT increased by 97.5% in FY16 to Rs. 1,258.9mn, while PAT margin expanded by around 90bps to 3%. RoE and RoCE increased from 12.9% and 22.6% in FY15 to 22.2% and 29.2%, respectively in FY16.

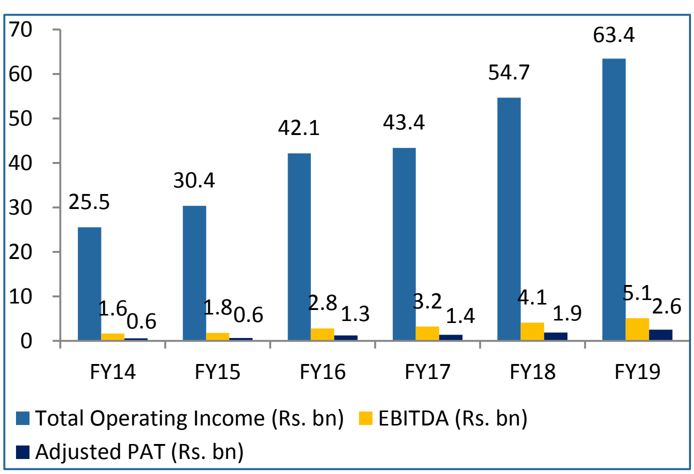
Annual Sales Mix



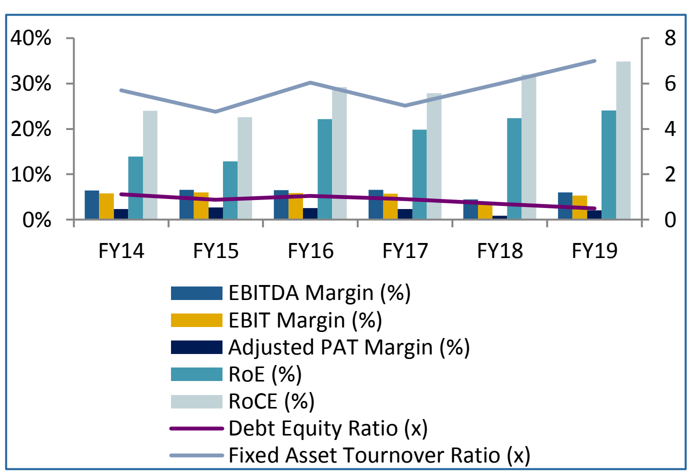
Annual Product-Wise Realization



Annual Financial Performance



Annual Profitability Trend



Source: Choice Broking Research

Source: Choice Broking Research

Recent Quarter and Annual Performance Analysis (Contd…):

Expectations for FY17: Reflecting the negative impact of the DeMo, in FY17 APL is expected to report a net sales growth of 1.9% to Rs. 42,141.4mn. This will be on account of 2% rise in the sales volume to 0.98mn tonnes. Blended realization is expected to be flat as compare to FY16 levels. Sale of value added products to increase from 73% in FY16 to 79.7% in FY17. Business from other operating activities to increase by 59.5%, thereby leading to a 3% rise in the consolidated total operating revenue in FY17 to Rs. 43,383.7mn. Operating expenditure to increase by 2.2% Y-o-Y, leading to a consolidated EBITDA of Rs. 3,225.5mn (+14.4% as compared to FY16). Higher proportion of niche products in sales-mix to lead to a 74bps expansion in EBITDA margin to 7.4%. With the change in the asset life, depreciation charge is expected to increase by 50.3%. Finance charge to remain flat on an annual basis. Consequently, adjusted PAT is likely to rise by 7.4% in FY17 to Rs. 1,352.4mn. PAT margin to report a modest expansion from 3% in FY16 to 3.1% in FY17.

Expectations for FY18: In FY18, APL is likely to commission the DFT and Raipur project. Aided by increased sales volume (+28.3%), net sales is expected to rise by 26.4%. Other operating income to report a growth of 12.7% over FY17. Thus consolidated operating revenue is likely to be at Rs. 54,668.4mn, representing an increase of 26% over the last year. EBITDA to increase in line with top-line and report a growth of 28%, with a margin of 7.6%. With the addition in the asset, depreciation charge to increase by 20.1%. Backed by slightly lower effective tax rate, adjusted PAT to increase by 39.6% in FY18 to Rs. 1,888.1mn, with around 30bps expansion in the PAT margin to 3.5%.

Risk and Concerns:

- **Subdued economic recovery post DeMo:** Sales of black round were affected due to DeMo. However, with higher sales to exports and OEMs, the company was able to post a sales growth of 8% in Q3 FY17. We believe that the impact of DeMo will be felt for another quarter and the situation will normalize from the start of FY18. Thus delay in the economic recovery will be negative for the company.
- **Poor acceptance of DFT based products:** DFT is expected to be a revolutionary technology in the Indian ERW pipe industry. APL, with first movers advantage is betting heavily on this technology. Poor acceptance of the DFT products by the consumers will be negative for it.
- **Increase in competition from existing players:** Currently, APL is not facing significant competition from its competitor, mainly due to its pan-India presence and economics of scale operations. Few of its competitors in South India (which is high growth area) are planning to expand their capacity, which might increase the competition. However, with cost efficient operations, we believe that the company will withstand these competitive pressures. Inability to handle competition will be highly negative for APL, as it operating in a low margin industry.
- **Volatility in the raw material prices:** Normally, APL passes on the increase/ decrease in the raw material prices to its consumers. However, there is a time lag to pass on the changes in the raw material prices. Since it operates in low margin industry, an inability to the transfer the impact of raw material to the consumer, will result in lower profitability for the company.

Peer Comparison:

Company Name	Face Value (Rs.)	CMP (Rs.)	MCAP (Rs. mn)	Stock Return (%) 1 M	3 M	6 M	1 Y	TTM Total Operating Revenue (Rs. mn)	TTM EBITDA (Rs. mn)	TTM PAT (Rs. mn)	TTM EBITDA Margin (%)	TTM PAT Margin (%)
APL Apollo Tubes Ltd.	**10**	**1,100.2**	**25,851**	**-1.4%**	**28.7%**	**17.3%**	**66.9%**	**43,136**	**3,355**	**1,322**	**7.8%**	**3.1%**
Maharashtra Seamless Ltd.	5	353.3	23,671	13.3%	54.6%	60.3%	157.3%	11,067	1,354	1,060	12.2%	9.6%
Surya Roshni Ltd.	10	182.0	7,977	-2.8%	-4.4%	-6.2%	35.4%	30,974	2,369	635	7.6%	2.1%
Ratnamani Metals & Tubes Ltd.	2	742.3	34,684	7.1%	22.3%	34.5%	73.2%	14,851	2,508	1,402	16.9%	9.4%
Goodluck India Ltd.	2	85	1,861	-12.3%	-6.3%	-25.9%	-5.4%	10,350	955	266	9.2%	2.6%
Rama Steel Tubes Ltd.	5	131	1,953	1.7%	12.9%	7.2%	49.6%	2,525	204	92	8.1%	3.6%
Hi-Tech Pipes Ltd.	10	140	1,441	-16.7%	28.9%	13.7%	141.2%	5,039	319	65	6.3%	1.3%
Vallabh Steels Ltd.	10	33	164	-3.1%	5.1%	16.4%	-1.1%	1,289	71	11	5.5%	0.8%
Welspun Corp. Ltd.	5	83	22,067	-1.0%	6.5%	6.3%	-10.8%	64,442	5,619	670	8.7%	1.0%
Average											**9.3%**	**3.8%**

Source: Choice Broking Research; Ace Equity

Company Name	EPS (Rs.)	BVPS (Rs.)	DPS (Rs.)	Debt Equity Ratio	Fixed Asset Turnover Ratio	RoE (%)	RoCE (%)	P / E (x)	P / B (x)	EV / Sales (x)	EV / EBITDA (x)	MCAP / Sales (x)
APL Apollo Tubes Ltd.	**56.2**	**276.4**	**10.0**	**0.8**	**6.0**	**20.3%**	**24.0%**	**19.6**	**4.0**	**0.7**	**9.3**	**0.6**
Maharashtra Seamless Ltd.	15.8	407.5	2.5	0.0	1.0	3.9%	3.2%	22.3	0.9	1.7	14.2	2.1
Surya Roshni Ltd.	14.5	162.4	1.0	1.1	3.9	8.9%	11.5%	12.6	1.1	0.5	6.6	0.3
Ratnamani Metals & Tubes Ltd.	30.0	236.1	5.5	0.0	3.0	12.7%	17.2%	24.7	3.1	2.3	13.4	2.3
Goodluck India Ltd.	12.1	100.4	1.5	1.6	4.1	12.0%	13.7%	7.0	0.8	0.5	5.5	0.2
Rama Steel Tubes Ltd.	6.1	21.4	0.0	1.4	12.8	28.7%	23.4%	21.3	6.1	0.9	10.9	0.8
Hi-Tech Pipes Ltd.	6.3	64.4	0.0	2.0	8.2	9.8%	12.3%	22.2	2.2	0.5	8.4	0.3
Vallabh Steels Ltd.	2.2	89.1	0.0	0.9	5.4	2.5%	6.1%	15.1	0.4	0.4	7.6	0.1
Welspun Corp. Ltd.	2.5	109.2	0.5	0.6	1.8	2.3%	2.8%	33.0	0.8	0.4	4.9	0.3
Average	**11.2**	**148.8**	**1.4**	**1.0**	**5.0**	**10.1%**	**11.3%**	**19.8**	**1.9**	**0.9**	**8.9**	**0.8**

Source: Choice Broking Research; Ace Equity

Of the above listed peers, APL is the market leader with a market share of 12.8%. Why APL is superior to its peers:

- Dominant player with a capacity of 1.3mn tonnes, which is expected to increase to 2mn tonnes by FY18
- Wide range of products with over 400+ varieties of ERW pipes
- Pan India presence with owned distribution network
- Pioneer in adapting the latest technology in the ERW pipe industry in India
- First movers advantage for the adaption of DFT
- With DFT, increased opportunity to tap exports and OEM market
- Expected to grab the market share of the unorganized players post the implementation of GST and
- One of the highly efficient company in the industry with consistent operating and financial performance

Valuation:

Based on the operating assumption mentioned below, we estimate APL's total operating income to grow at 14.6% CAGR over FY16-19 to Rs. 63,414.5mn, while PAT to grow at 26.5% CAGR over the same period to Rs. 2,550.3mn. The company ticks all the required parameters needed for a good company. It is the market leader in terms of installed capacity and sales volume. Besides this, it is one of the efficient players in the ERW pipe industry, largely benefiting from the pan-India presence and economics of scale operations. The company is consistently paying dividends with pay out in the range of 11-20% over the last three years.

At the CMP of Rs. 1,100.2, APL's share is trading at TTM P/E multiple of 19.6x as against the peer average of 19.8x. Additionally, it is trading at a P/BVPS and EV/EBITDA multiple of 4x and 9.3x, respectively as compared to the peer average of 1.9x and 8.9x. However, its fixed asset turnover ratio, RoE and RoCE are significantly higher as compared to its peers. We are of the opinion that the market has not factored in its competitive advantage and the benefits arising from the adaptation of DFT project. Based on EV/EBITDA multiple of 7.5x to FY19E EBITDA, we arrive at a target price of Rs. 1,436.5 per share, translating into a potential gain of 30.6%. Thus we recommend a **"BUY"** rating on the stock.

Assumptions	FY17	FY18	FY19
ERW Steel Pipe Manufacturing Capacity (mn tonnes)	1.4	2.0	2.0
Sales Volume (mn tonnes)	1.0	1.3	1.5
Sales-Mix (%)			
Black Pipe	15.6%	15.3%	14.5%
Structure	48.3%	55.9%	60.8%
GI Pipe	12.1%	9.4%	7.9%
GP Pipe	19.2%	14.9%	12.5%
Coils and Others	4.7%	4.4%	4.4%
Blended Realization (Rs.)	43,152	42,522	41,248
EBITDA per Tonne (Rs.)	3,466.0	3,447.7	3,583.7
Tax Rate (%)	36.3%	35.3%	34.9%

Source: Choice Broking Research

Particular (Rs. mn)	Multiple	FY19
EBITDA	7.5	5,133.8
Enterprise Value		**38,689.7**
Less Non Equity Claims		(5,285.3)
Add Excess Cash		350.2
Equity Value		**33,754.6**
Total Shares O/s		23.5
Target Price		**1,436.5**

Source: Choice Broking Research

Consolidated Financial Statement

Consolidated Profit and Loss Statement						
Rs. mn	**FY14**	**FY15**	**FY16**	**FY17E**	**FY18E**	**FY19E**
Total Operating Income	**25,508.8**	**30,359.9**	**42,121.8**	**43,383.7**	**54,668.4**	**63,414.5**
(Increase) / Decrease In Stocks	523.6	40.1	211.2	875.2	1,224.0	1,349.6
Cost of Services & Raw Materials	(22,178.0)	(26,941.2)	(29,913.9)	(31,532.6)	(42,113.9)	(49,204.4)
Purchase of Finished Goods	(428.6)	(109.1)	(5,923.5)	(5,337.5)	(4,600.0)	(4,600.0)
Operating & Manufacturing Expenses	(1,444.9)	(1,126.0)	(3,046.1)	(3,420.9)	(4,167.7)	(4,806.9)
Employee Cost	(335.5)	(392.4)	(631.0)	(742.4)	(880.6)	(1,018.9)
EBITDA	**1,645.5**	**1,831.3**	**2,818.5**	**3,225.5**	**4,130.1**	**5,133.8**
Depreciation Expenses	(164.3)	(220.1)	(341.0)	(512.4)	(615.2)	(680.6)
EBIT	**1,481.2**	**1,611.2**	**2,477.5**	**2,713.1**	**3,514.9**	**4,453.1**
Interest Expenses	(609.3)	(664.6)	(695.2)	(702.7)	(728.9)	(689.2)
Interest / Dividend Income	0.0	0.0	0.0	9.2	0.0	0.0
Other Income	20.4	30.0	100.7	103.7	130.7	151.6
Exceptional Items	(2.6)	0.0	(253.3)			
EBT	**889.7**	**976.6**	**1,629.8**	**2,123.3**	**2,916.8**	**3,915.5**
Tax Expenses	(299.9)	(339.2)	(624.2)	(770.9)	(1,028.7)	(1,365.3)
PAT	**589.8**	**637.4**	**1,005.5**	**1,352.4**	**1,888.1**	**2,550.3**
Adjusted PAT	**592.4**	**637.4**	**1,258.8**	**1,352.4**	**1,888.1**	**2,550.3**

Source: Choice Broking Research

Consolidated Balance Sheet Statement						
Rs. mn	**FY14**	**FY15**	**FY16**	**FY17E**	**FY18E**	**FY19E**
Share Capital	234.4	234.4	234.4	234.4	234.4	234.4
Share Warrants & Outstandings	0.0	0.0	0.0	0.0	0.0	0.0
Total Reserves	4,017.8	4,716.6	5,441.1	6,590.4	8,194.9	10,362.2
Long-Term Borrowings	1,371.8	1,406.2	1,875.9	1,945.1	1,368.5	791.9
Deferred Tax Assets / Liabilities	521.2	744.6	859.0	908.0	1,144.2	1,327.2
Other Long Term Liabilities	1.0	10.6	10.4	10.4	10.4	10.4
Long Term Provisions	23.7	29.2	50.7	44.0	55.4	64.3
Trade Payables	1,241.7	2,045.4	2,540.0	1,801.6	2,478.6	3,029.6
Other Current Liabilities	411.4	867.6	1,041.1	883.8	1,113.7	1,291.9
Short Term Borrowings	3,402.6	2,925.6	4,109.1	4,292.8	4,493.5	4,493.5
Short Term Provisions	277.0	655.0	957.7	745.8	939.8	1,090.1
Total Liabilities	**11,502.6**	**13,635.2**	**17,119.4**	**17,456.3**	**20,033.4**	**22,695.5**
Net Block	4,200.2	6,140.8	6,661.8	8,204.6	8,897.9	8,943.3
Capital Work in Progress	245.0	203.5	319.9	433.8	218.7	126.8
Intangible Assets Under Development	33.8	36.2	0.0			
Non Current Investments	175.7	190.6	131.3	0.0	0.0	0.0
Long Term Loans & Advances	449.5	480.2	569.0	0.0	0.0	509.2
Other Non Current Assets	0.0	28.1	23.9	23.9	23.9	23.9
Current Investments				0.0	0.0	81.7
Inventories	2,884.9	3,195.6	5,943.7	4,674.6	5,894.5	6,813.7
Sundry Debtors	2,494.3	1,752.5	2,198.6	3,515.4	4,237.3	4,658.0
Cash and Bank Balance	100.8	188.2	13.5	183.7	231.5	268.5
Other Current Assets	120.0	507.4	416.5	420.3	529.6	614.3
Short Term Loans and Advances	681.1	797.2	841.2	0.0	0.0	656.1
Miscellaneous Expenses not Written Off	117.3	114.9	0.0	0.0	0.0	0.0
Total Assets	**11,502.6**	**13,635.2**	**17,119.4**	**17,456.3**	**20,033.4**	**22,695.5**

Source: Choice Broking Research

Consolidated Financial Statement (Contd...)

Consolidated Cash Flow Statement						
Particulars	**FY14**	**FY15**	**FY16E**	**FY17E**	**FY18E**	**FY19E**
Profit Before Tax	**889.7**	**976.7**	**1,629.9**	**2,123.3**	**2,916.8**	**3,915.5**
Interest & Financial Charges	609.3	664.4	695.1	702.7	728.9	689.2
Depreciation / Amortization	164.3	220.1	341.0	512.4	615.2	680.6
Change in Working Capital	(92.0)	1,366.6	(2,334.7)	(1,116.7)	(702.7)	(353.2)
Others	2.6	(12.8)	213.8	(9.2)	0.0	0.0
Tax Expenses	(246.8)	(67.0)	(432.1)	(770.9)	(1,028.7)	(1,365.3)
Cash Flow from Operations Activities	**1,327.1**	**3,148.0**	**113.0**	**1,441.7**	**2,529.5**	**3,567.0**
Purchase of Fixed Assets	(1,277.9)	(1,839.0)	(1,256.4)	(2,169.2)	(1,093.4)	(634.1)
Change in Investments	(163.6)	(15.0)	(18.2)	131.3	0.0	(81.7)
Change in Loans & Advances				1,410.2	0.0	(1,165.3)
Interest Income	0.0	9.9	29.6	9.2	0.0	0.0
Others	162.7	(64.7)	318.2	0.0	0.0	0.0
Cash Flow from Investing Activities	**(1,278.8)**	**(1,908.8)**	**(926.8)**	**(618.5)**	**(1,093.4)**	**(1,881.1)**
Borrowings (Net)	528.6	(442.6)	1,672.6	252.9	(375.9)	(576.6)
Finance Costs	(609.3)	(664.4)	(695.1)	(702.7)	(728.9)	(689.2)
Dividend Paid	(129.7)	(117.2)	(140.6)	(173.1)	(241.6)	(326.4)
Others	121.3	(19.0)	(28.1)	(30.0)	(42.0)	(56.7)
Cash Flow from Financing Activities	**(89.2)**	**(1,243.2)**	**808.8**	**(653.0)**	**(1,388.3)**	**(1,648.9)**
Net Cash Flow	**(41.0)**	**(4.0)**	**(5.0)**	**170.2**	**47.8**	**37.0**
Opening Balance of Cash & Cash Balance	141.8	19.2	15.2	13.5	183.7	231.5
Closing Balance of Cash & Cash Balance	**100.8**	**15.2**	**10.2**	**183.7**	**231.5**	**268.5**

Source: Choice Broking Research

Consolidated Financial Ratios						
	FY14	**FY15**	**FY16**	**FY17E**	**FY18E**	**FY19E**
Profitability & Return Ratios						
EBITDA Margin (%)	6.5%	6.0%	6.7%	7.4%	7.6%	8.1%
PAT Margin (%)	2.3%	2.1%	3.0%	3.1%	3.5%	4.0%
RoNW (%)	13.9%	12.9%	22.2%	19.8%	22.4%	24.1%
RoCE (%)	24.0%	22.6%	29.2%	27.9%	31.9%	34.8%
Working Capital & Liquidity Ratios						
Current Ratio (X)	1.2	1.0	1.1	1.1	1.2	1.3
Quick Ratio (X)	0.7	0.5	0.4	0.5	0.6	0.6
Interest Coverage Ratio	2.4	2.4	3.6	3.9	4.8	6.5
Turnover & Leverage Ratios						
Fixed Asset Turnover (X)	5.7	4.8	6.0	5.0	6.0	7.0
Total Asset Turnover (X)	2.2	2.2	2.5	2.5	2.7	2.8
Debt Equity Ratio (X)	1.1	0.9	1.1	0.9	0.7	0.5
Dividend Pay Out Ratio	21.9%	18.4%	11.2%	12.8%	12.8%	12.8%
Valuation Ratios						
DPS (Rs.)	5.5	5.0	6.0	7.4	10.3	13.9
BVPS (Rs.)	181.0	210.7	241.5	290.4	358.7	451.0
EPS (Rs. Cr)	25.2	27.1	53.6	57.6	80.4	108.5
P / E (X)				19.1	13.7	10.1
P / BVPS (X)				3.8	3.1	2.4
EV / EBITDA (X)				9.9	7.6	6.0

Source: Choice Broking Research

Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform, the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform, the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral.

Rating Legend	
Rating	**Upside**
BUY	Absolute Return >15%
Accumulate	Absolute Return Between 10-15%
Hold	Absolute Return Between 0-10%
Reduce	Absolute Return 0 To Negative 10%
Sell	Absolute Return > Negative 10%

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Disclaimer

POTENTIAL CONFLICT OF INTEREST DISCLOSURE (as on date of report) Disclosure of interest statement – • Analyst interest of the stock /Instrument(s): - No. • Firm interest of the stock / Instrument (s): - No.

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