APL Apollo Tubes

03 August 2017

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IIFL Institutional Equities

Strong execution ability; geared for growth

- APL Apollo Tubes (Apollo) has emerged as the largest manufacturer of Electric Resistance Welded (ERW) steel tubes in India, supported by strong 21% Cagr in manufacturing capacity over FY12-17. A large capacity combined with investments in distribution and branding has driven 26% volume Cagr and 27% revenue Cagr for the company over FY12-17.
- The company continues to invest in capacity expansion from 1.3mtpa to 2mtpa, including addition of 0.5mtpa of DFT-based capacity, which would enable superior products and smaller delivery timelines, and engender higher profitability.
- Geographically well-spread manufacturing capacity (to contain logistics costs) and efficient manufacturing processes have ensured cost competitiveness vs. unorganised as well as organised players.
- A product portfolio that is twice as big as the nearest competition along with a few patented designs should ensure that company would continue to benefit from growing demand for steel pipes from construction, auto, energy, and agriculture and from spending on infrastructure.
- Healthy operating and free cash flow should ensure that debt levels would continue to come down steadily over FY17-20. This will support EPS growth at much faster levels compared with volume/revenue growth, going forward.

IIFL's score-card for unrated companies

Key Positives	Score of 1-5 (with 5 as most positive)	Key Risks	Score of 1-5 (with 5 as most risky)
Industry growth potential	✓✓✓	Regulatory	××
Dominant position within the industry	✓✓✓✓	Corporate Governance	××
Balance-sheet strength, profitability ratios	✓✓✓	Competition (including possible foreign)	×××
Execution track record of management	✓✓✓✓	Liquidity (trading volume)	××××

CMP	**Rs1581**
Market cap (US$m)	**585**
Enterprise value(US$m)	**676**
Bloomberg	**APAT IN**
Sector	**Metals**

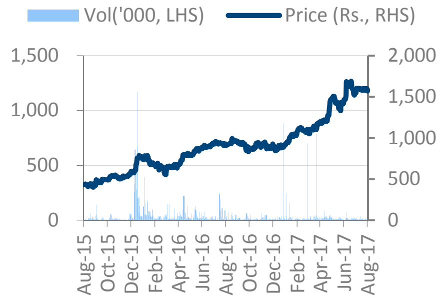
Shareholding pattern (%)

Promoter	37.5
FII	23.7
DII	15.2
Others	23.6
52Wk High/Low (Rs)	1742/811
Shares o/s (m)	24
Daily volume (US$ m)	0.3
Dividend yield FY16ii (%)	0.8
Free float (%)	62.5

Price performance (%)

	1M	3M	1Y
Absolute (Rs)	2.1	6.6	69.7
Absolute (US$)	3.3	7.3	78.8
Rel. to Sensex	-3.0	-1.9	53.6
Cagr (%)			**3 yrs**
EPS			34.8

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Consolidated	FY14A	FY15A	FY16A	FY17A
Revenues (Rs m)	24,970	31,383	42,136	45,450
Ebitda margins (%)	*6.6*	*5.8*	*6.7*	*7.1*
Pre-exceptional PAT (Rs m)	592	638	1,259	1,459
Reported PAT (Rs m)	590	638	1,006	1,459
Pre-exceptional EPS (Rs)	25.3	27.2	53.7	61.8
Growth (%)	*(18.7)*	*7.6*	*97.5*	*15.1*
PER (x)	**62.6**	**58.1**	**29.4**	**25.6**
ROE (%)	*14.9*	*13.9*	*23.7*	*22.7*
Net debt/equity (x)	1.1	0.8	1.1	0.8
EV/Ebitda (x)	25.4	22.7	15.3	13.3
Price/book (x)	8.7	7.5	6.5	5.2

Source: Company, IIFL Research. Priced as on 02 August 2017

Anupam Gupta | anupam.gupta@iiflcap.com
91 22 4646 4641

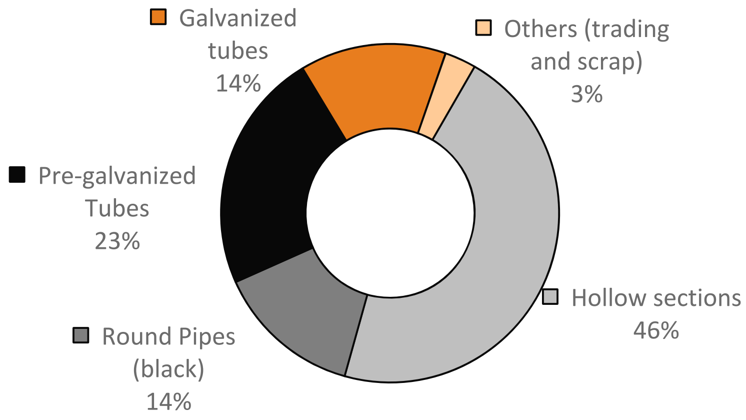
Urvil Bhatt | urvil.bhatt@iiflcap.com
91 22 4646 4648

Leading steel pipes company

APL Apollo Tubes (formerly Bihar Tubes) commenced operations in 1986 as a private limited company promoted by late Mr. Sudesh Gupta. It has emerged as one of India's leading ERW steel tubes manufacturer with a capacity of 1.3mtpa spread out evenly across northern, southern, and western India. The company is commissioning 0.2mtpa greenfield capacity at Raipur to cater to markets in eastern India. It is also adding lines of new DFT mills (500ktpa) at existing sites in the four regions, which would enable it to offer superior products with lower turnaround times to customers.

Apollo's product profile includes hollow sections, pre-galvanized tubes, galvanized tubes, round pipes and special value added products (door and window frames and railing tubes). At least 70% of the company's products are niche categories that have limited competition. Its products cover a range of industry applications such as urban infrastructure, automobile, construction, housing, energy, irrigation, and solar plants. Over the years, the company has established a strong distribution network across India with more than 600 dealers and 26 warehouses.

Figure 1: Hollow sections and pre-galvanized tubes largest revenue contributors in FY17



*split for revenue from manufactured goods. Source: Company, IIFL Research

Figure 2: Management profile

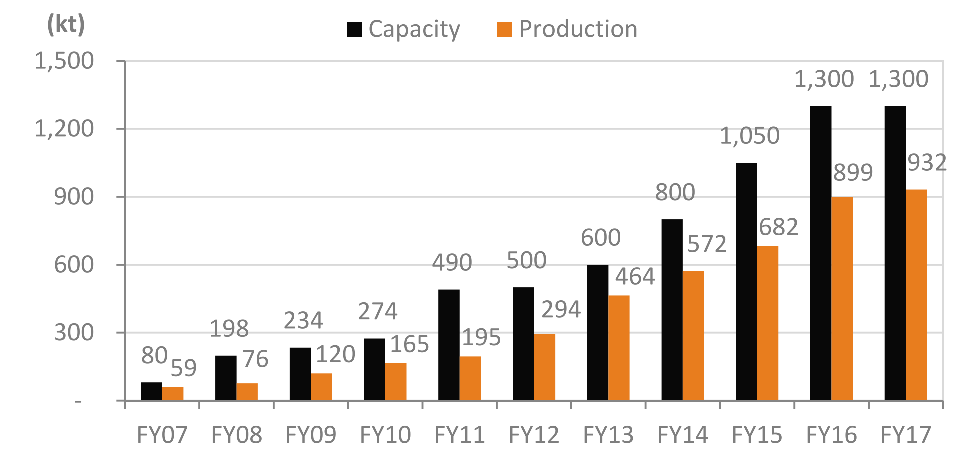
Name	Designation	Descripiton
Sanjay Gupta	Executive Chairman	He has over 2 decades of experience in various steel industry segments. He is responsible for steering the company with a clear vision of growth in context with changing market scenarios. Under his leadership, the company grew exponentially gaining national and international recognition.
Ashok Gupta	Managing Director	He is a steel industry veteran with over three decades of experience. He has earlier worked at senior management positions in SAIL, Bhushan Steel, LN Mittal Group (African Continent), Jindal, etc. He has been instrumental in transforming the organization and generating incremental profitability and expansions.
Vinay Gupta	Director	He has over 18 years of experience in exports and international markets. 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.

Source: Company, IIFL Research

Strong volume growth supported by expanding capacity

Apollo has expanded its capacity at 32% Cagr over the past decade from 80kt in 2007 to 1.3mt at present spread over six facilities across India. It has used the organic and inorganic route to expand capacity. Its major acquisitions include Apollo Metalex Pvt Limited in 2007, Shri Lakshmi Metal Udyog in 2008, and Lloyds Line Pipes Limited in 2012. In line with capacity expansions, the company has delivered strong 32% volume Cagr in over the past decade.

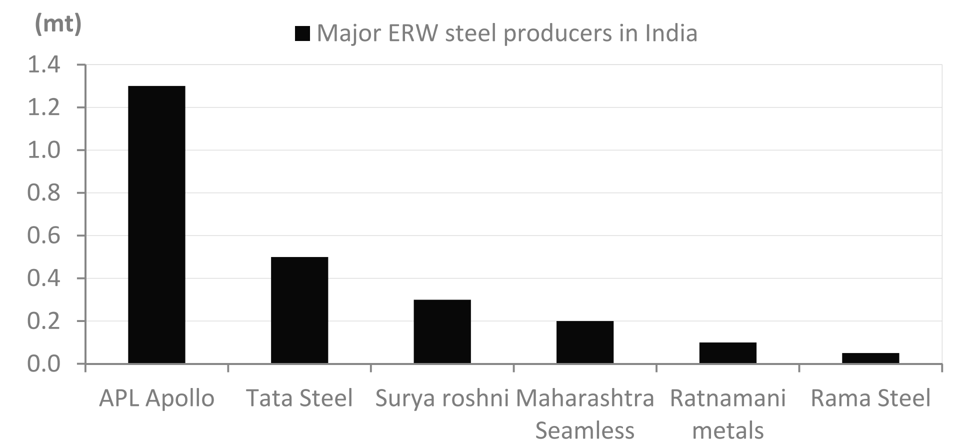
Figure 3: Strong volume growth history



Source: Company, IIFL Research

Importantly, Apollo's capacity expansion has come about during the period when capacity of the overall organized industry has grown at a much slower pace. Thus, Apollo has benefited from market share gains from organized as well as unorganized competitors.

Figure 4: Apollo is the largest ERW steel player in domestic market



Source: Industry data, IIFL Research

Targeting capacity of 2mtpa (+54%) by end FY18

The management intends to continue with its aggressive expansion plans to drive volume growth over FY17-19. With a view to tap the market in eastern India, the company is investing Rs1.25bn to set up a 325kt greenfield capacity in Raipur, Chhattisgarh. One production line out of the planned six lines has been commissioned and management expects to commence production on all lines by 3QFY18.

Figure 5: Geographically well spread operations

Plant wise capacity (kt)	State	Existing	DFT(planned)	Total
Murbad	Maharashtra	350	125	**475**
Hosur	Tamil Nadu	350	125	**475**
Sikandarabad	Uttar Pradesh	475	125	**600**
Bengaluru	Karnataka	125	-	**125**
Raipur	Chhattisgarh	200	125	**325**
Total		**1,500**	**500**	**2,000**

Source: Company, IIFL Research

The company is also setting up new lines of Direct Form Technology (DFT) mills with a total capacity of 500kt split equally between its existing facilities in Sikandarabad, Hosur, Raipur, and Murbad. It has earmarked capex of Rs1.25bn for these mills.

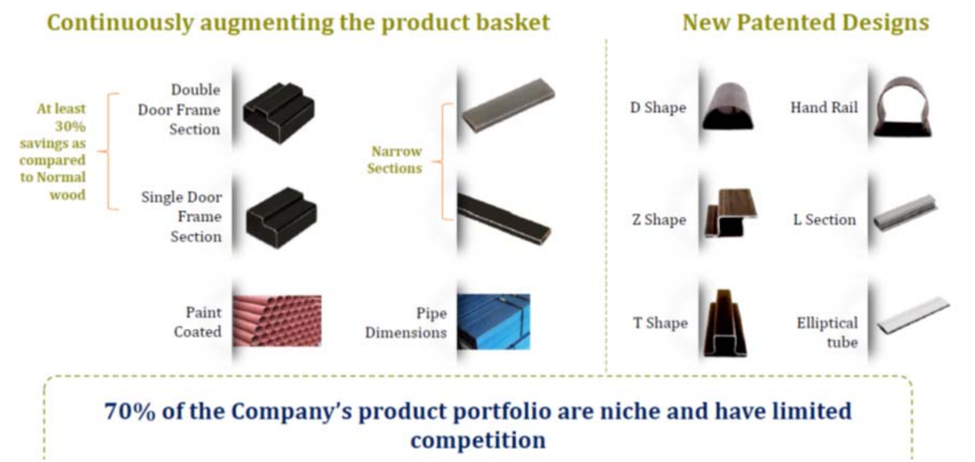
DFT Technology to improve product mix and aid margins

Apollo introduced the latest global technology - Direct forming technology (DFT) in India in 2016. Under this technology, hollow sections of various shapes, sizes, and thickness are formed directly through high speed welding. It enables customised orders including size customisation. It also reduces rollover time to ~20 mins from 24-48 hours earlier under conventional technology. Besides saving time, it also enables direct material savings of ~3-7%.

This technology enables booking of small orders and enables quick turnaround time, reducing working capital requirements. It also opens an array of opportunities across various sectors such as metros, airports, prefabricated buildings, agricultural implements, solar tracking systems and various applications in the automobile industry. The high quality of customised shapes and sizes of products manufactured using DFT would enable the company to penetrate OEMs and the exports market. The company is setting up a 0.5mtpa DFT capacity across its existing facilities, expected to be commissioned by end FY18.

Apollo is also upgrading facilities to increase proportion of high-margin value added products. The company has ventured into precision tubes for automotive application. It is also setting up an inline galvanizing plant and is upgrading existing lines to the galvanized product technology.

Figure 6: Product innovation has been key to strong volume growth for APL Apollo

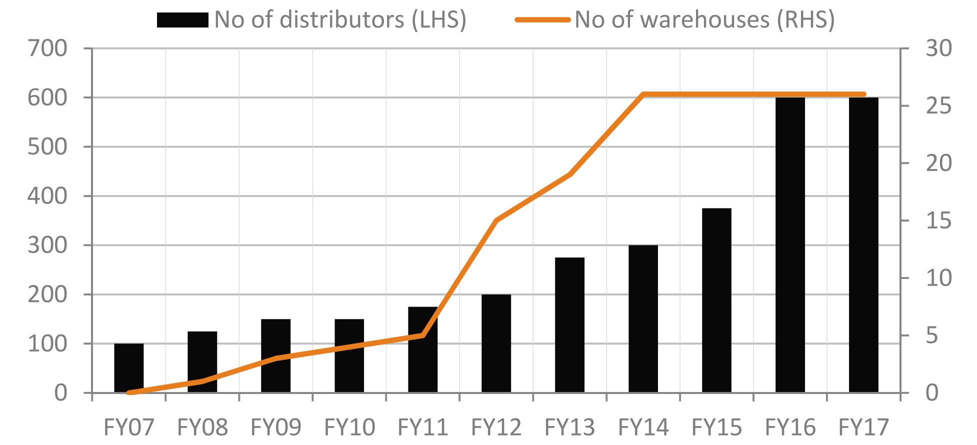


Source: Company, IIFL Research

Building entry barriers through distribution & branding

Apollo derives 80% of sales from distributors. Sale of pipes is through warehouses that cater to dealers/distributors who in turn sell to retailers. The company is expanding its business across India in new cities, towns and villages and it has increased its distribution reach over the past few years. Apollo has presence in over 300 cities and towns across India, with 26 warehouses, 600 distributors, and 40,000 retailers. Distribution reach and warehouses have expanded rapidly over the past few years in line with growing volumes. The company has introduced innovative incentive schemes for dealers such as a four-day Star Cruise to Singapore and Malaysia for over 1000 dealers and distributors.

Figure 7: Sharp increase in distributors and warehouses over the past decade



Source: Company, IIFL Research

In 2013, the company developed a focused branding strategy to create awareness and visibility of the brand and provide customers a first-hand feel of the brand. These initiatives have resulted in better sales growth in tier II and III cities than in tier I cities. Sales in small towns and villages are also growing due to increased brand awareness. The company has improved presence in trade expos, fabricator meetings, and it has focused advertising and brand engagement programmes (rural brand van activation programmes). It is also focusing on reaching out to fabricators, small traders, and farmers.

The management is working with a reputed marketing consultant to launch new brands under "APL Apollo" to cover the company's unique and innovative product portfolio. The company is targeting ~30k signage boards across the country for higher visibility.

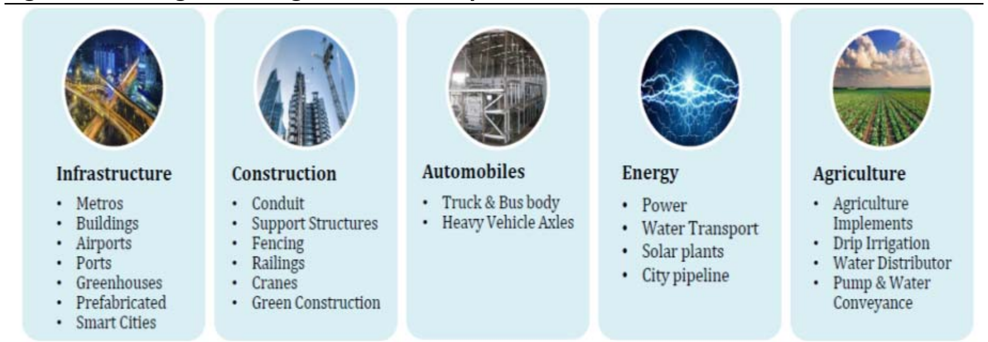
The company launched 'Apollo Coastguard' pipes, a new brand that will tap growing consumption of galvanized steel tubes in coastal regions. This product would be made of special galvanized steel to provide corrosion resistance against wind, water, making them 100% rust proof.

The company has announced a strategic tie-up with NEXTracker to manufacture a key structural component of its solar tracking system in India. NEXTracker would get highest quality steel products sourced for its solar parks and power plants in India. This tie-up also allows Apollo to penetrate rapidly into the growing renewable energy market in India. As per estimates, the expected 100GW of solar power capacity by 2022 would require more than 1mt of premium pre-galvanized hollow section tubes.

Improving demand to drive volume growth from expanded capacities

India is one the leading ERW steel pipes and tubes manufacturing hub globally with ~7mtpa capacity. The domestic market size for ERW steel pipes is ~300bn. Apollo is the largest manufacturer of ERW steel pipes and tubes in India with current capacity of 1.3mtpa. Increase in demand from the infrastructure, construction, automobile and refining sectors continues to propel growth for ERW steel pipes and tubes.

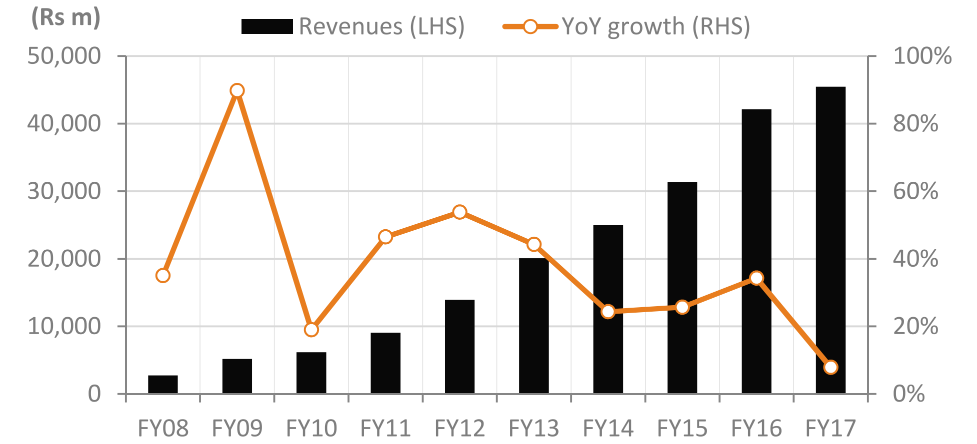
Figure 8: Strong demand growth driven by infra, construction and auto sectors



Source: Company, IIFL Research

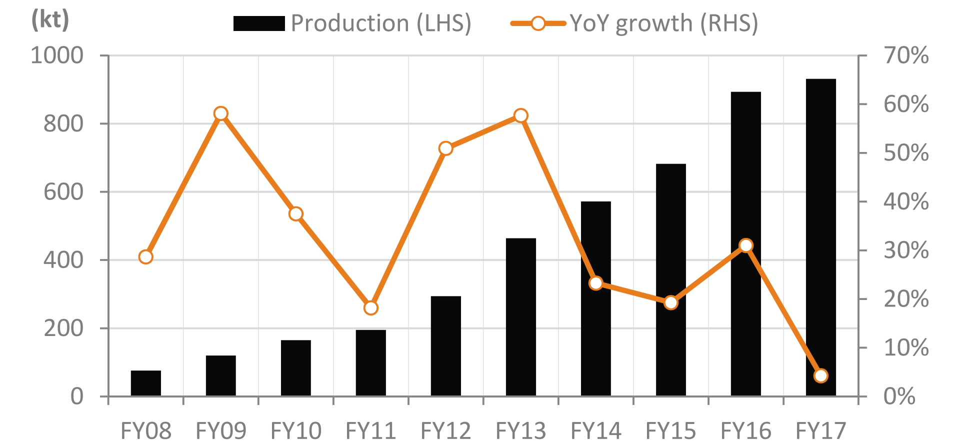
Although overall demand is likely to grow by 9-10% annually, Apollo's volume growth should be higher since it continues to gain market share from organised as well as from unorganised competitors.

Figure 9: APL Apollo tubes delivered 36.5% revenue Cagr over the past decade…



Source: Company, IIFL Research

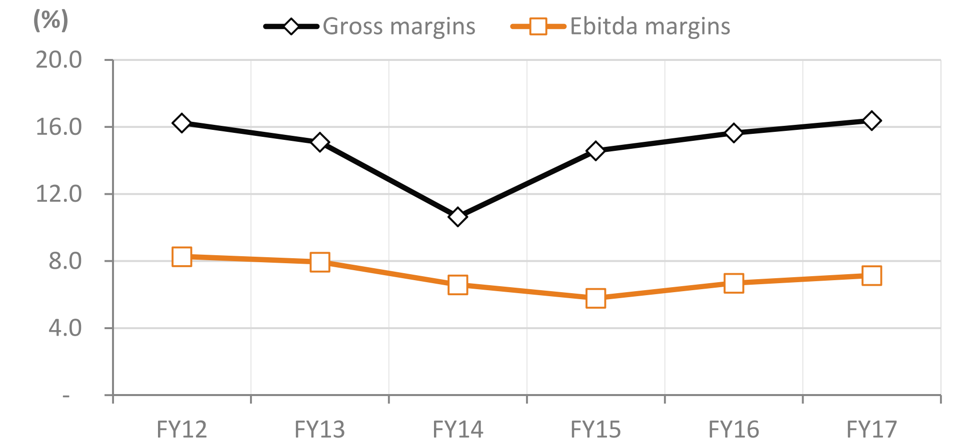
Figure 10: …on the back of 32% volume growth in FY07-17



Source: Company, IIFL Research

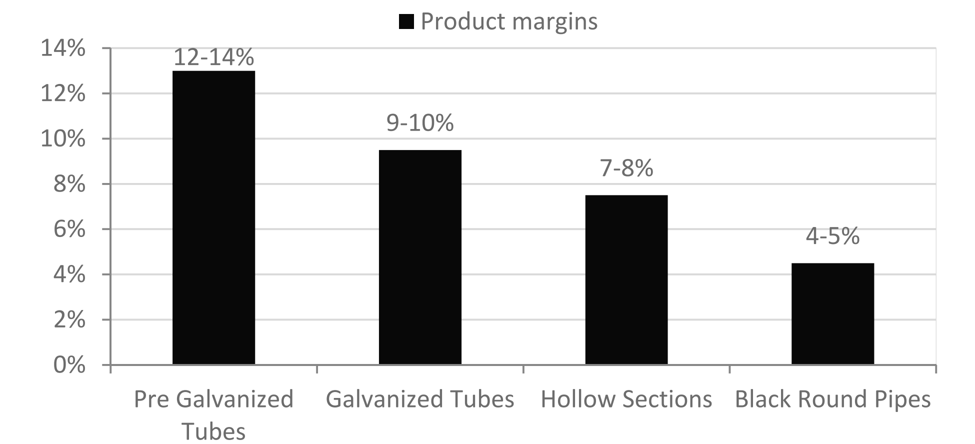
Given that ~90% of costs are on steel, the key raw material, profitability is exposed to variations in steel price over the short term. However, the company has generally been able to pass through the changes in steel prices to customers with a short lag. This trend should continue going forward. Ebitda margins have seen an improvement in the past two years, led primarily by increasing stickiness of customers, and slightly better pricing power vs. competition. Ebitda margins will get support going forward as share of DFT product increases as these will fetch higher margins than traditional ERW steel pipes.

Figure 11: Both gross margins and Ebitda margins are expected to rise steadily over FY17-19 as product mix improves



Source: Company, IIFL Research

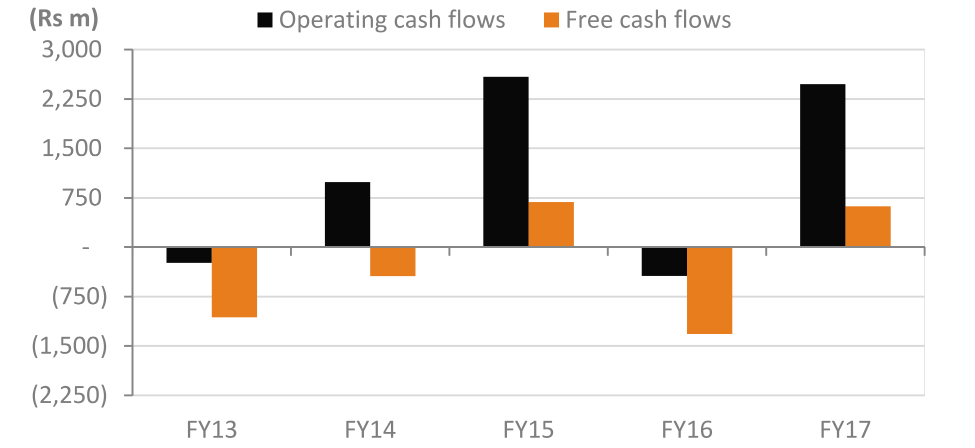
Figure 12:Rising proportion of galvanized tubes and DFT should drive margin expansion



Source: Company, IIFL Research

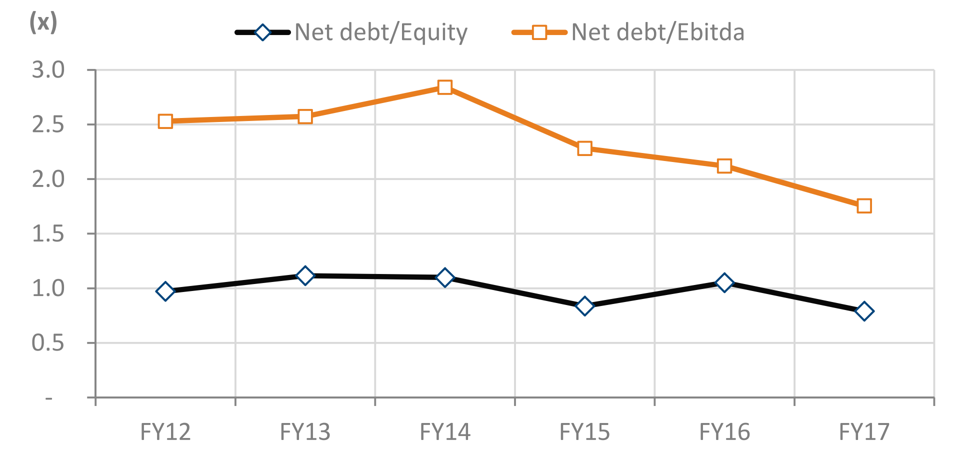
PAT growth has been higher as debt and interest costs have come down on the back of healthy cash flows.

Figure 13: Investments in new capacities impacted FCF generation



Source: Company, IIFL Research

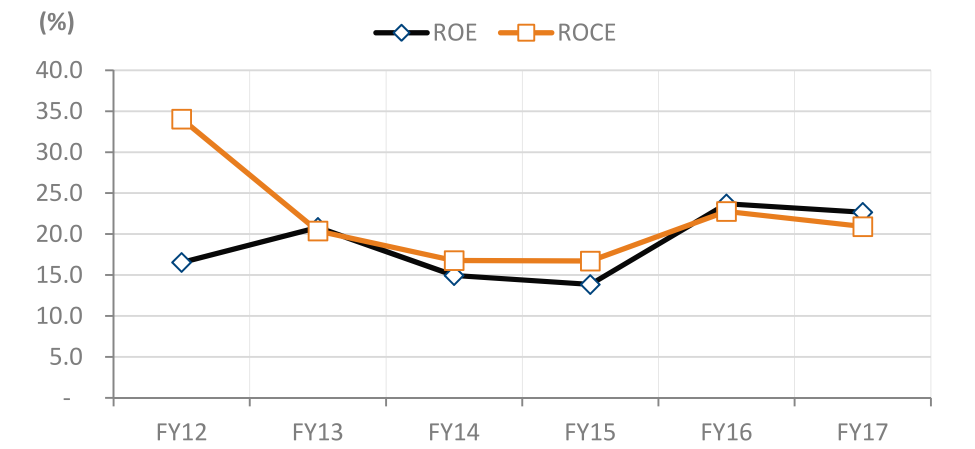
Figure 14: Leverage ratios have come down and this trend should continue



Source: Company, IIFL Research

Overall, we expect return ratios to improve steadily over the next few years, driven by higher profitability and improving asset turns.

Figure 15:ROE and ROCE have improved from the low of FY15 and should inch up steadily



Source: Company, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar, Consolidated	FY14A	FY15A	FY16A	FY17A
Revenues	**24,970**	**31,383**	**42,136**	**45,450**
Ebitda	1,646	1,816	2,817	3,244
Depreciation and amortisation	(164)	(220)	(341)	(512)
Ebit	1,481	1,596	2,476	2,732
Non-operating income	20	45	103	38
Financial expense	(609)	(664)	(695)	(683)
PBT	892	977	1,883	2,086
Exceptionals	(3)	0	(253)	0
Reported PBT	890	977	1,630	2,086
Tax expense	(300)	(339)	(624)	(627)
PAT	590	638	1,006	1,459
Minorities, Associates etc.	0	0	0	0
Attributable PAT	**590**	**638**	**1,006**	**1,459**

Ratio analysis

Y/e 31 Mar, Consolidated	FY14A	FY15A	FY16A	FY17A
Per share data (Rs)				
Pre-exceptional EPS	25.3	27.2	53.7	61.8
DPS	5.0	6.0	9.9	12.0
BVPS	181.4	211.2	242.1	305.3
Growth ratios (%)				
Revenues	24.3	25.7	34.3	7.9
Ebitda	3.1	10.4	55.1	15.2
EPS	(18.7)	7.6	97.5	15.1
Profitability ratios (%)				
Ebitda margin	6.6	5.8	6.7	7.1
Ebit margin	5.9	5.1	5.9	6.0
Tax rate	33.7	34.7	38.3	30.1
Net profit margin	2.4	2.0	2.4	3.2
Return ratios (%)				
ROE	14.9	13.9	23.7	22.7
ROCE	16.8	16.7	22.8	20.9
Solvency ratios (x)				
Net debt-equity	1.1	0.8	1.1	0.8
Net debt to Ebitda	2.8	2.3	2.1	1.8
Interest coverage	2.4	2.4	3.6	4.0

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar, Consolidated	FY14A	FY15A	FY16A	FY17A
Cash & cash equivalents	101	188	14	17
Inventories	2,885	3,196	5,944	4,696
Receivables	2,494	1,753	2,199	2,952
Other current assets	801	897	740	1,344
Creditors	1,242	2,045	2,540	3,704
Other current liabilities	688	1,115	1,481	899
Net current assets	**4,351**	**2,873**	**4,875**	**4,406**
Fixed assets	4,280	5,951	6,519	7,863
Intangibles	199	429	462	706
Investments	176	191	131	127
Other long-term assets	567	623	593	795
Total net assets	**9,572**	**10,067**	**12,581**	**13,898**
Borrowings	4,774	4,332	5,985	5,707
Other long-term liabilities	546	784	920	988
Shareholders equity	**4,252**	**4,951**	**5,676**	**7,203**
Total liabilities	**9,572**	**10,067**	**12,581**	**13,898**

Cash flow summary (Rs m)

Y/e 31 Mar, Consolidated	FY14A	FY15A	FY16A	FY17A
Ebit	1,481	1,596	2,476	2,732
Tax paid	(300)	(339)	(624)	(627)
Depreciation and amortization	164	220	341	512
Net working capital change	(3)	1,524	(2,125)	292
Other operating items	231	206	88	212
Operating cash flow before interest	1,574	3,207	155	3,120
Financial expense	(609)	(664)	(695)	(683)
Non-operating income	20	45	103	38
Operating cash flow after interest	**985**	**2,588**	**(437)**	**2,475**
Capital expenditure	**(1,263)**	**(1,892)**	**(942)**	**(1,859)**
Long-term investments	(164)	(15)	59	4
Others	(3)	0	(254)	0
Free cash flow	**(444)**	**682**	**(1,574)**	**619**
Equity raising	11	0	0	2
Borrowings	529	(443)	1,653	(278)
Dividend	(136)	(152)	(254)	(340)
Net chg in cash and equivalents	(41)	87	(175)	3

Source: Company data, IIFL Research

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A graph of daily closing prices of securities is available at http://www.nseindia.com/ChartApp/install/charts/mainpage.jsp, www.bseindia.com and http://economictimes.indiatimes.com/markets/stocks/stock-quotes. (Choose a company from the list on the browser and select the "three years" period in the price chart).

Name, Qualification and Certification of Research Analyst: Anupam Gupta(PGDBM), Urvil Bhatt(Chartered Accountant)

India Infoline Limited (Formerly "India Infoline Distribution Company Limited"), CIN No.: U99999MH1996PLC132983, Corporate Office – IIFL Centre, Kamala City, Senapati Bapat Marg, Lower Parel, Mumbai – 400013 Tel: (91-22) 4249 9000 .Fax: (91-22) 40609049, Regd. Office – IIFL House, Sun Infotech Park, Road No. 16V, Plot No. B-23, MIDC, Thane Industrial Area, Wagle Estate, Thane – 400604 Tel: (91-22) 25806650. Fax: (91-22) 25806654 E-mail: mail@indiainfoline.com Website: www.indiainfoline.com, Refer www.indiainfoline.com for detail of Associates.

National Stock Exchange of India Ltd. SEBI Regn. No. : INB231097537/ INF231097537/ INE231097537, Bombay Stock Exchange Ltd. SEBI Regn. No.:INB011097533/ INF011097533/ BSE-Currency, MCX Stock Exchange Ltd. SEBI Regn. No.: INB261097530/ INF261097530/ INE261097537, United Stock Exchange Ltd. SEBI Regn. No.: INE271097532, PMS SEBI Regn. No. INP000002213, IA SEBI Regn. No. INA000000623, SEBI RA Regn.:- INH000000248

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, i.e. a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, i.e. return of less than 10%.

Distribution of Ratings: Out of 198 stocks rated in the IIFL coverage universe, 108 have BUY ratings, 5 have SELL ratings, 63 have ADD ratings and 22 have REDUCE ratings

Price Target: Unless otherwise stated in the text of this report, target prices in this report are based on either a discounted cash flow valuation or comparison of valuation ratios with companies seen by the analyst as comparable or a combination of the two methods. The result of this fundamental valuation is adjusted to reflect the analyst's views on the likely course of investor sentiment. Whichever valuation method is used there is a significant risk that the target price will not be achieved within the expected timeframe. Risk factors include unforeseen changes in competitive pressures or in the level of demand for the company's products. Such demand variations may result from changes in technology, in the overall level of economic activity or, in some cases, in fashion. Valuations may also be affected by changes in taxation, in exchange rates and, in certain industries, in regulations. Investment in overseas markets and instruments such as ADRs can result in increased risk from factors such as exchange rates, exchange controls, taxation, and political and social conditions. This discussion of valuation methods and risk factors is not comprehensive – further information is available upon request.