Global Markets Research

India | Pipes

Initiating Coverage

8 July 2019

APL Apollo Tubes

Staying hungry

Sustainable growth: ERW pipe industry CAGR of ~7% in FY19-21E

The domestic electric resistance welded (ERW) pipe industry posted a demand CAGR of ~5% over FY16-19, and we expect the industry to grow at a CAGR of ~7% over FY19-21E to ~8 mn tonnes by FY21E, led by higher government spending (~INR 1tn) towards several projects like metro, airport, urban development, irrigation & water sanitation and rising demand of prefabricated structures, followed by steady demand from traditional applications, like water transportation & sewage and oil & gas.

High flier: history of growing ~3x of industry growth

APL Apollo Tubes (APL IN) is a market leader in the domestic ERW pipe industry with a current market share of ~18%. It is among the fastest-growing ERW pipe firms, with a capacity CAGR of ~24% over FY09-19. During the past three years, it has grown ~3x rate of industry growth, and we believe is well placed to continue strong momentum, given its 1) industry-leading capacity of 2.3mn tonnes, 2) low cost structure, and 3) pan-India presence with a vast distribution network

Multiple triggers: margin expansion by 100bp over FY19-21E

We expect margin to expand by 100bp to 6.7% over FY19-21E, led by 1) improved operating leverage & higher contribution from direct forming technology (DFT) (20bp margin contribution), 2) better inventory management (60bp margin contribution), and 3) improved realization with continued endeavor for value-added products (20bp margin contribution).

Balance sheet to strengthen: net debt-equity ratio to halve

We believe absence of major capacity expansion in the near term and performance improvement will help generate free cashflow of INR 3.2bn over FY20-21E, thereby lead to faster deleveraging of balance sheet. Deleveraging alone is likely to give ~4% upside to the stock price. We expect a decline in net debt-equity to 0.4x in FY21E from 0.8x in FY19.

Rating: Buy

Target Price: INR 2,267

Upside: 41%

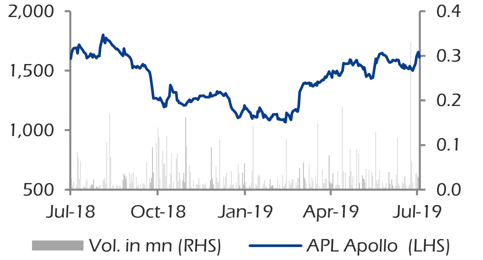
CMP: INR 1,610 (as on 5 July 2019)

Key data

Bloomberg /Reuters Code	APAT IN/APLA.BO
Current /Dil Shares O/S (mn)	24/24
Mkt Cap (INR bn/USD mn)	39/570
Daily Volume (3M NSE Avg)	1,329
Face Value (INR)	10
1 USD= INR 68.5	

Note: pricing as on 5 July 2019; Source: Bloomberg

Price & Volume



Source: Bloomberg

Shareholding (%)	Q1FY19	Q2FY19	Q3FY19	Q4FY19
Promoter	37.3	37.3	37.3	37.1
Institutional Investor	12.0	13.1	13.6	13.9
Other Investor	36.9	36.5	34.7	35.5
General Public	13.9	13.2	14.5	13.6

Source: BSE

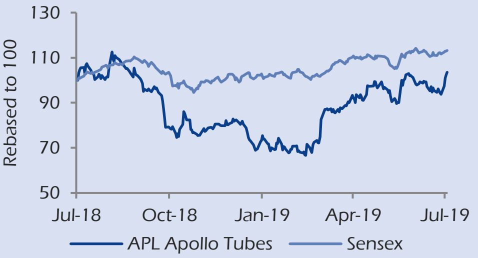
Price performance (%)	3M	6M	12M
Sensex	1.7	10.7	11.1
APL Apollo	7.4	36.1	(3.8)

Source: Bloomberg

Valuation

We expect a revenue CAGR of ~21% and an EPS CAGR of ~49% over FY19-21E, led by 1) a volume CAGR of ~19%, 2) improved efficiency, 3) better product portfolio, and 4) likely reduction in the net debt-equity ratio to 0.4x in FY21E from 0.8x in FY19. Therefore, we initiate on APL Apollo Tubes with a **Buy** rating and a TP of INR 2,267, implying ~41% upside. Our TP is based on 16.5x FY21E P/E, which is in line with the past five-year average of 16.3x. Fundamentals in FY21 are likely to be stronger than in the past five years as FY21E ROE is likely to be at 24.1% vs a five-year average of 19.7% while FY21E net debt-equity ratio of 0.4x vs 1.0x in the past five years. The stock is currently trading at 11.7x FY21E P/E.

Price performance



Source: Bloomberg

Key Financials

YE March	Revenue (INR mn)	YoY (%)	EBITDA (INR mn)	EBITDA margin (%)	Adj PAT (INR mn)	YoY (%)	Fully DEPS (INR)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY18	51,561	35.5	3,710	7.2	1,581	4.0	66.6	20.5	20.7	24.2	12.3
FY19	68,946	33.7	3,928	5.7	1,482	(6.2)	62.2	16.5	18.4	25.9	11.6
FY20E	84,858	23.1	5,059	6.0	2,179	47.0	89.9	19.8	21.6	17.9	9.0
FY21E	101,794	20.0	6,856	6.7	3,332	52.9	137.4	24.1	26.8	11.7	6.5

Note: pricing as on 5 July 2019; Source: Company, Elara Securities Estimate

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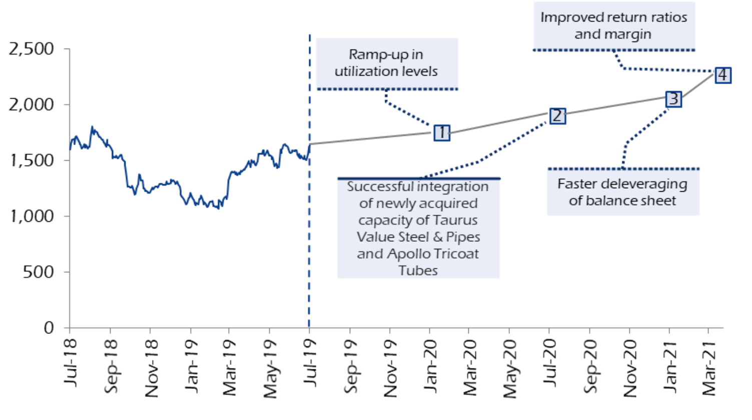
Valuation trigger



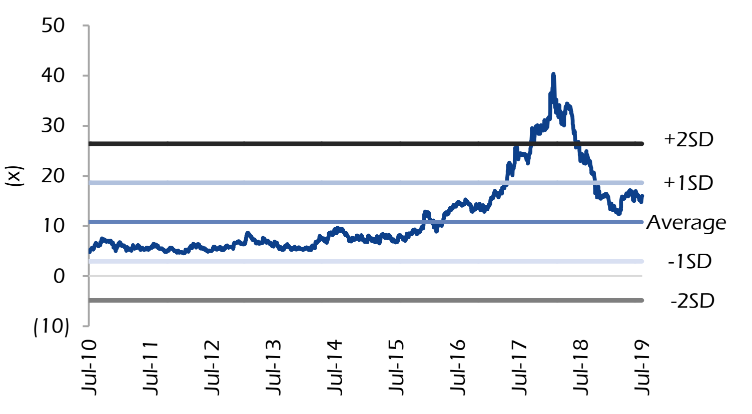
Source: Bloomberg, Elara Securities Estimate

Valuation overview

(INR mn)	FY21E
Target P/E	16.5
EPS (INR)	137.4
TP (INR)	**2,267**
CMP (INR)	1,610
Upside (%)	41

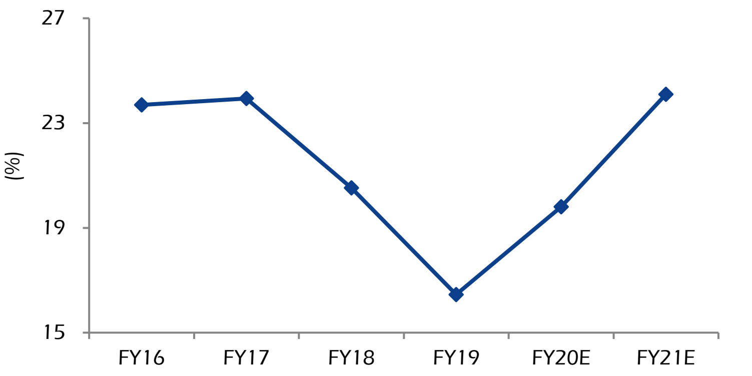
Note: pricing as on 5 July 2019; Source: Elara Securities Estimate

Valuation: five-year average P/E stands at 16.3x



Source: Bloomberg, Company, Elara Securities Estimate

ROE to expand by 765bp to 24.1% over FY19-21E



Source: Bloomberg, Company, Elara Securities Estimate

Investment summary

- Industry leading capacity of 2.3mn tonnes pa to drive a volume CAGR of ~19% over FY19-21E to 1.9mn tonnes
- ERW pipe industry to post a demand CAGR of ~7% over FY19-21E
- EBITDA CAGR of ~32% over FY19-21E, led by higher volume growth and improved efficiency
- Improved financials with higher return ratios, reduction in debt and healthy free cashflow generation

Valuation trigger

1. Ramp-up in utilization levels
2. Successful integration of newly acquired capacity of Taurus Value Steel & Pipes and Apollo Tricoat Tubes
3. Faster deleveraging of balance sheet
4. Improved return ratios and margin

Key risks

- Steel price fluctuations may be a drag on margin
- Below expected demand pickup to drag volume growth
- Increased competition to restrict pricing power
- Threat of substitution may lead to lower demand

Our assumptions

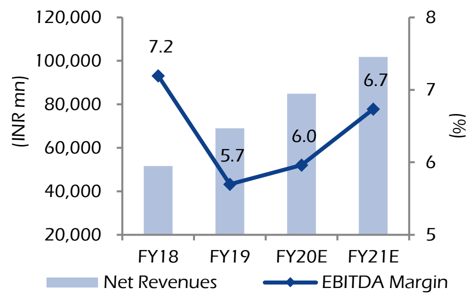
- Volume CAGR of ~19% during FY19-21E to 1.9mn tonne
- Improvement in EBITDA margin to 6.7% in FY21E from 5.7% in FY19

Consolidated Financials (YE March)

Income Statement (INR mn)	FY18	FY19	FY20E	FY21E
Net Revenue	51,561	68,946	84,858	101,794
Operating profit	**1,924**	**1,352**	**2,089**	**3,293**
Add:- Other operating Income	1,786	2,577	2,970	3,563
EBITDA	**3,710**	**3,928**	**5,059**	**6,856**
Less :- Depreciation & Amortization	534	643	739	855
Add: Other income	80	117	123	124
EBIT	**3,256**	**3,403**	**4,443**	**6,126**
Less:- Interest Expenses	813	1,134	1,091	999
PBT	**2,443**	**2,269**	**3,352**	**5,126**
Less :- Taxes	862	787	1,173	1,794
Reported PAT	**1,581**	**1,482**	**2,179**	**3,332**
Reported PAT after Minority Interest	**1,581**	**1,482**	**2,179**	**3,332**
Adjusted PAT after Minority Interest	**1,581**	**1,482**	**2,179**	**3,332**
Balance Sheet (INR mn)	**FY18**	**FY19**	**FY20E**	**FY21E**
Share Capital	237	239	243	243
Reserves	8,141	9,402	12,119	15,049
Borrowings	7,751	8,119	7,465	6,912
Deferred Tax (Net)	994	1,200	1,260	1,272
Other liabilities	374	584	595	602
Total Liabilities	**17,498**	**19,543**	**21,681**	**24,078**
Gross Block	9,504	11,734	13,734	15,734
Less:- Accumulated Depreciation	985	1,628	2,366	3,221
Net Block	**8,519**	**10,106**	**11,368**	**12,513**
Add:- Capital work in progress	460	275	275	275
Non-current investments	120	494	494	494
Net Working Capital	7,002	6,216	7,220	8,009
Cash & current investments	68	478	351	814
Other assets	1,329	1,974	1,974	1,974
Total Assets	**17,498**	**19,543**	**21,681**	**24,078**
Cash Flow Statement (INR mn)	**FY18**	**FY19**	**FY20E**	**FY21E**
Cash profit adjusted for non-cash items	3,029	3,347	3,945	5,074
Add/Less : Working Capital Changes	(2,378)	787	(1,004)	(788)
Operating Cash Flow	651	4,134	2,941	4,286
Less:- Capex	(1,944)	(2,045)	(2,000)	(2,000)
Free Cash Flow	(1,292)	2,089	941	2,286
Financing Cash Flow	1,015	(777)	(1,191)	(1,947)
Investing Cash Flow	330	(902)	123	124
Net change in Cash	**52**	**410**	**(127)**	**463**
Ratio Analysis	**FY18**	**FY19**	**FY20E**	**FY21E**
Income Statement Ratios (%)				
Revenue Growth	35.5	33.7	23.1	20.0
EBITDA Growth	18.2	11.4	5.9	28.8
Adj. PAT Growth	4.0	(6.2)	47.0	52.9
EBITDA Margin	7.2	5.7	6.0	6.7
Adj. Net Margin	3.1	2.2	2.6	3.3
Return & Liquidity Ratios (%)				
Net Debt/Equity (x)	0.9	0.8	0.6	0.4
ROE	20.5	16.5	19.8	24.1
ROCE	20.7	18.4	21.6	26.8
Per Share data & Valuation Ratios				
Diluted EPS (INR)	66.6	62.2	89.9	137.4
EPS Growth (%)	3.3	(6.7)	44.6	52.9
DPS (INR)	14.0	14.0	15.0	16.0
P/E Ratio (x)	24.2	25.9	17.9	11.7
EV/EBITDA (x)	12.3	11.6	9.0	6.5
EV/Sales (x)	0.9	0.7	0.5	0.4
P/BV(x)	5.0	4.3	3.5	2.8
Dividend Yield (%)	0.9	0.9	0.9	1.0

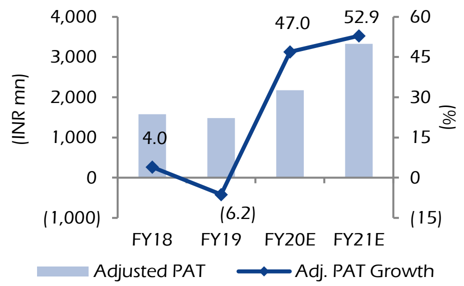
Note: pricing as on 5 July 2019; Source: Company, Elara Securities Estimate

Revenue & margin growth trend



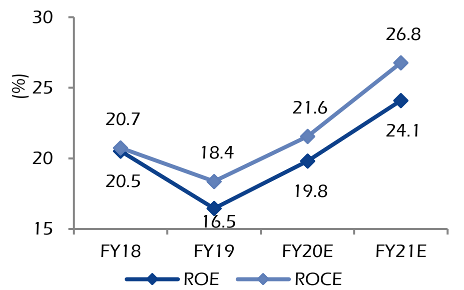
Source: Company, Elara Securities Research

Adjusted profit growth trend



Source: Company, Elara Securities Research

Return ratios



Source: Company, Elara Securities Research

Pipes

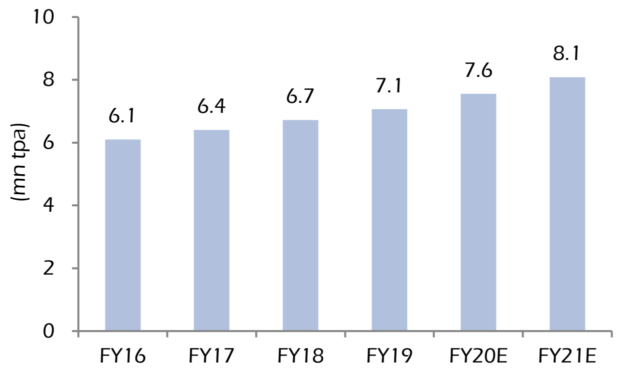
Set for sustainable growth

- **ERW pipe industry to grow at a CAGR of ~7% over FY19-21E**
- **Government-backed infra and social projects to bolster demand**
- **Low-cost structure and surplus capacity to gain market share by 600bp by FY21E**

Demand CAGR of ~7% over FY19-21E

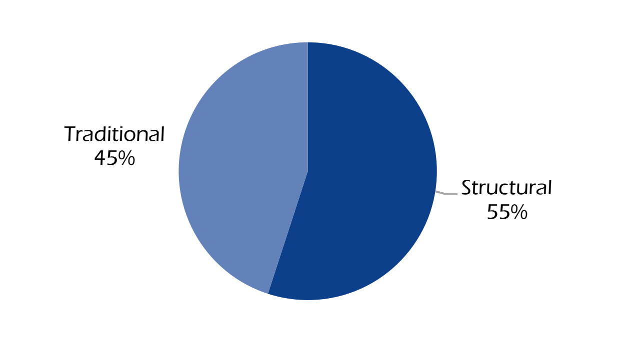
The domestic ERW pipe industry grew at a steady pace of ~5% over FY16-19 and current demand stands ~7mn tonnes. The industry has been witnessing a gradual change in consumption patterns under which structural support systems, which are primarily used in modern infrastructure, such as airports, malls, metros, sprinklers and prefabricated structures, have emerged as key end-users for ERW pipe compared to traditional use in transportation of water & sewage and oil & gas. We believe structural systems will continue to gain traction in the upcoming years, and, thus, expect ERW pipe industry to report demand CAGR of ~7% over FY19-21E.

Exhibit 1: ERW pipe industry demand CAGR of ~7% over FY19-21E



Source: CRISIL, Elara Securities Estimate

Exhibit 3: Structural segment contributes bigger pie



Note: FY19; Source: Company, Elara Securities Research

Exhibit 2: Use of ERW pipes gaining traction across sectors

Construction & Building	Infrastructure	Energy & Engineering	Automobiles	Agriculture
Material	Metros	Solar plants	Truck & bus body	Agriculture implements
Green construction	Airports	Power plants	Heavy vehicle Axles	Drip irrigation
Buildings & Smart Cities	Ports	Cranes		Water distributor
Structural steel	Prefabricated	Gym equipment		Pump & water conveyance
Fencing	Gas pipelines	Heavy engineering goods		Greenhouses
Hand railing	Telecom towers			
Roofing	Poles			
Scaffolding	Stadiums			
Window & door frame				
Ducting				
Furniture				
Firefighting				

Source: Company, Elara Securities Research

Infra & social projects to drive demand

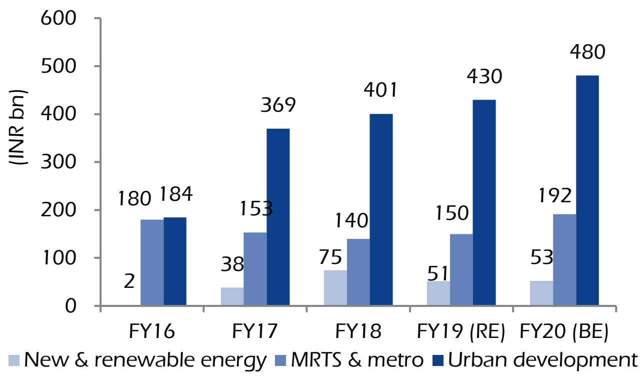
We have been witnessing a notable improvement in government spending on infra and social projects for the past few years, which has led to a meaningful improvement in demand of ERW pipes. As per FY19-20 Union Budget, government of India is likely to invest up to INR 1tn on several key government-backed infra (renewable energy, metro, irrigation and urban development) and social projects (Atal Mission for Rejuvenation and Urban-AMRUT, National Rural Drinking Water Programme-NRDWM) during FY20 and we believe improved execution of these projects will strengthen demand for ERW pipes.

The following are some key segments witnessing strong government push and are expected to be key demand drivers for ERW pipes:

Construction & infra: higher outlay to boost demand

Rising urbanization and government's improved focus towards upgrading infrastructure has led to healthy traction in construction and infrastructure activities. Over the years, ERW pipes have emerged as a key substitute for traditional construction methods and are being used as conduits, support structures to make fences, railings & scaffolding and in building prefabricated structures. We believe the government's strong focus on infrastructure spending will lead to higher construction activities, and notable improvement in demand for ERW pipes. In Union Budget FY19-20, outlays have been increased by ~2% YoY for renewables, ~28% YoY for metro and ~12% YoY for urban development.

Exhibit 4: Rise in investment in key government-backed infra projects

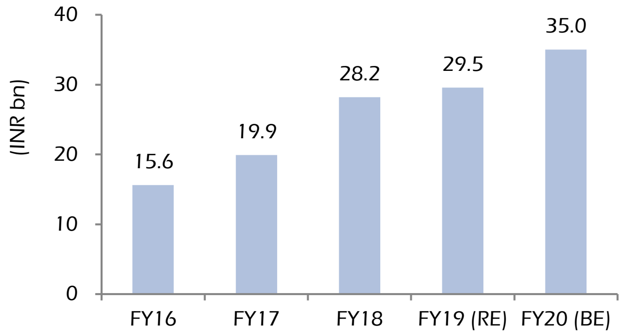


Source: Union Budget, Elara Securities Research

Irrigation: Central outlay increases by 2%

The government has initiated several schemes and increased investment to tackle issues pertaining to an irregular Monsoon and falling groundwater levels. Given that ERW pipes are preferred in building sprinklers, drill rods, bore wells and water distribution submersible pumps, rising investment in irrigation will bolster demand for ERW pipes. In FY19-20 Union Budget, outlay for irrigation has been increased by ~2% YoY.

Exhibit 5: Gradual rise in government investment in irrigation projects

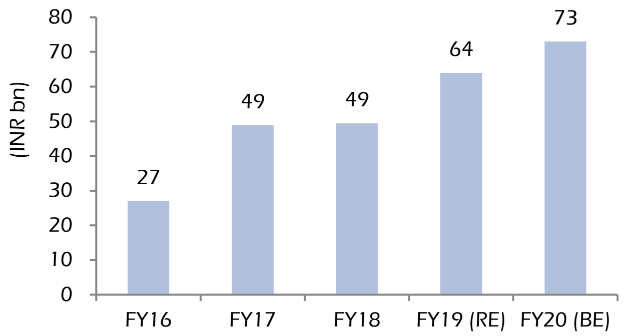


Source: Union Budget; Elara Securities Research

Water supply & sanitation: NRDWM outlay rises 8%

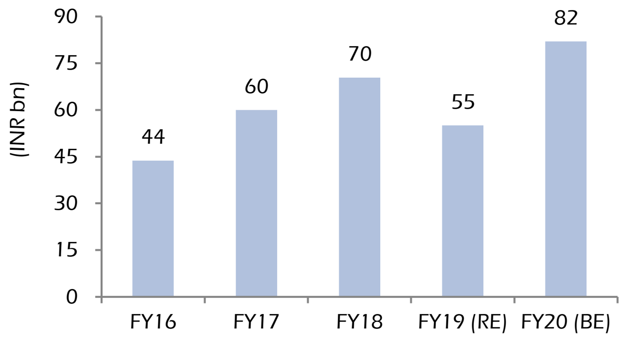
Access to clean drinking water and efficient sewage system have been key major challenges for India. However, government's renewed focus on these issues with key social welfare initiatives, such as Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and National Rural & Drinking Water Mission (NRDWM), are expected to drive demand for ERW pipes. In Union Budget FY19-20, outlays have been increased by ~1% YoY for AMRUT and ~8% YoY for NRDWM.

Exhibit 6: Investment towards AMRUT on rising trend



Source: Union Budget, Elara Securities Research

Exhibit 7: ~8% YoY rise in NRDWM spending in FY20



Source: Union Budget, Elara Securities Research

Pipes

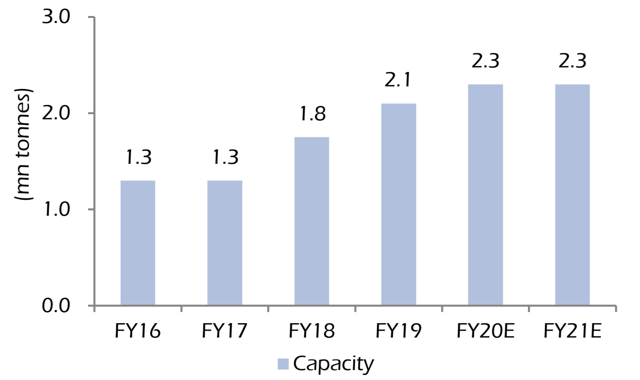
High flier

Established firm with industry-leading capacity

APL is a market leader in the domestic ERW pipe industry with a current market share of ~18%. Capacity addition at regular intervals has been the key growth strategy for APL in the past. During the past three years, it has grown ~3x rate of industry growth. It has added capacity at a CAGR of ~24% over FY09-19 through organic and inorganic routes.

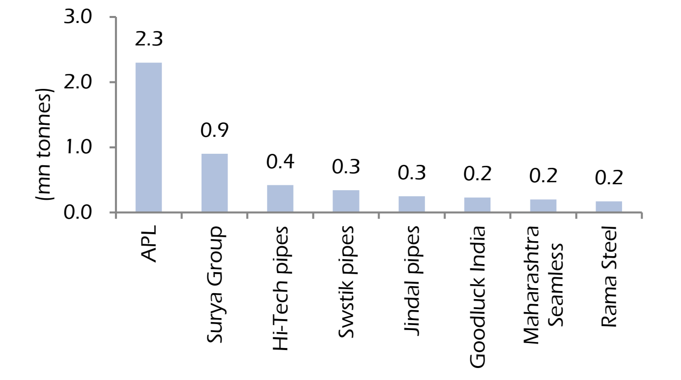
From having a mere 234,000 tonne of capacity in FY09, the company today is a market leader in the domestic ERW pipe industry, with an installed capacity of 2.3mn tonnes as on Q1FY20, well ahead of its peers. It has eight manufacturing units across the central, northern, southern and western regions.

Exhibit 8: Capacity addition continues



Source: Company, Elara Securities Estimate

Exhibit 9: APL capacity more than 2x of its nearest peer



Note: Jun'19; Source: Company, Elara Securities Estimate

Exhibit 10: Organic & inorganic expansion enables APL to grow at ~24% CAGR over FY09-19

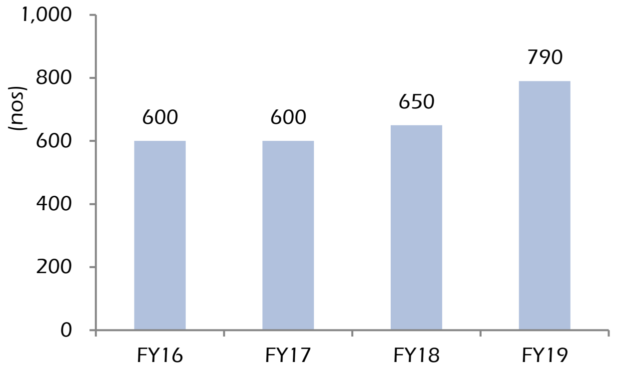
Plants details	Location	Capacity type	Current capacity	Comments
Unit-1	Sikandarabad (UP)	Organic	350,000	Commissioned first manufacturing unit in 1986
Unit-1 & 2 (Apollo Metalex)	Sikandarabad (UP)	Inorganic	350,000	APL acquired Apollo Metalex (with a 24,000 tonne pa sheet galvanizing capacity) in 2007 and paid INR 12.1mn to acquire a 100% stake
North			700,000	
Lloyds Line Pipes	Murbad (Maharashtra)	Inorganic	400,000	APL acquired Lloyds Line Pipes (LLPL) in November 2010 having an annual capacity of 90,000 tonne pa at Murbad, near Mumbai and paid INR 400mn in cash to acquire a 100% stake
West			400,000	
Unit 2	Hosur (Tamil Nadu)	Organic	550,000	Commissioned over 2009-10
Shri Lakshmi Metal Udyog	Bengaluru (Karnataka)	Inorganic	100,000	APL acquired Shri Lakshmi Metal Udyog at Bengaluru with an annual tube-making capacity of ~50,000 tonne pa. It was a non-cash share swap deal and the estimated deal value was INR 340mn
Taurus Value Steel & Pipes	Hyderabad (Telangana)	Inorganic	200,000	Completed acquisition of Taurus Value Steel & Pipes on 3 June 2019 for ~INR 700mn
South			850,000	
Raipur unit	Raipur (Chhattisgarh)	Organic	350,000	Greenfield capacity addition completed in FY18
Central			350,000	
Total capacity			2,300,000	

Source: Company, Elara Securities Research

Deeply entrenched distribution network

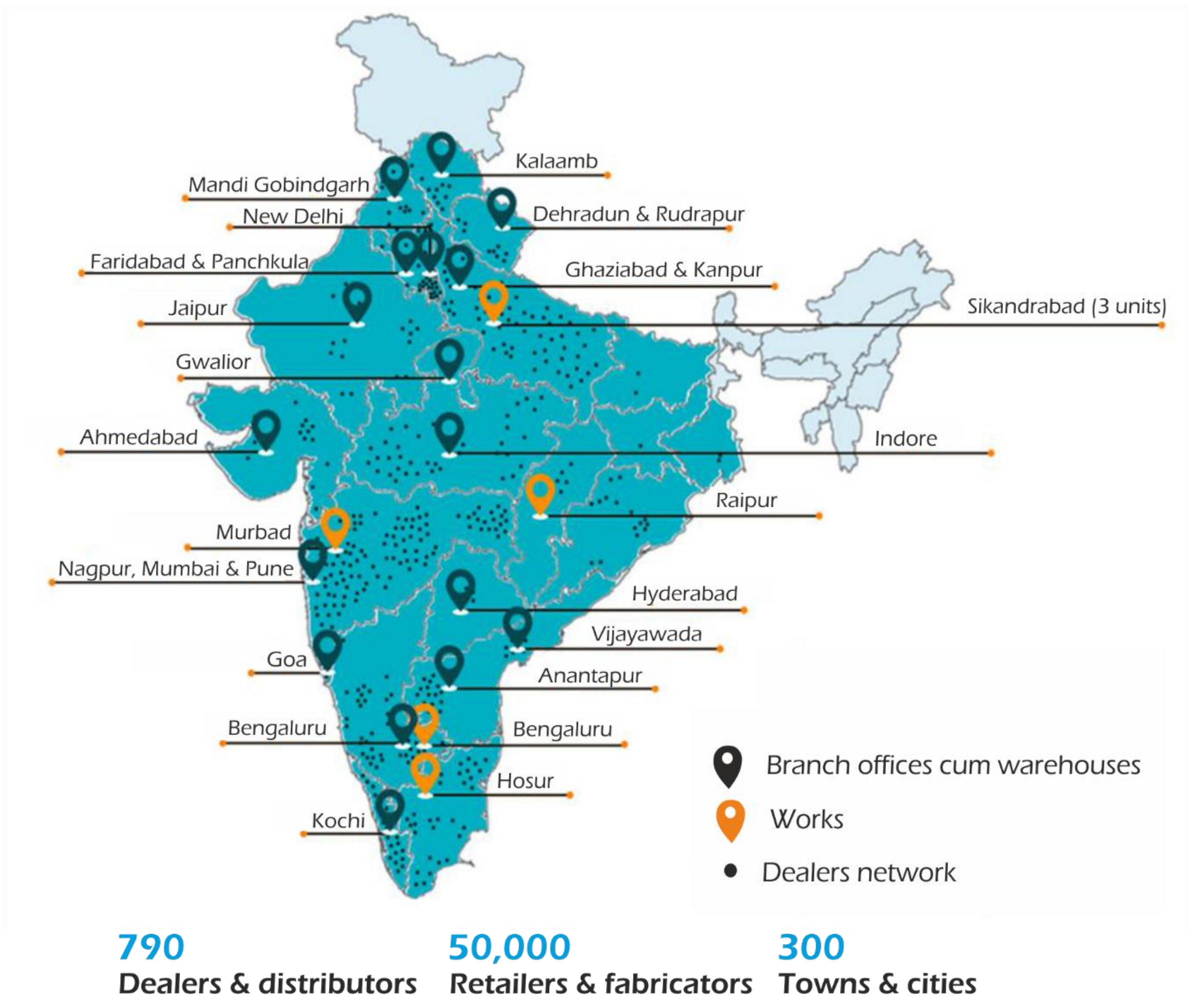
The company enjoys pan-India presence on the back of eight manufacturing facilities across different regions of India. It has three plants in North India, three in South India and one each in the central and western regions. South India is its biggest market where the company sells up to 40% of its products, followed by ~30% in West India, ~20% in North India and the rest in other markets. It has a vast distribution network, supported by 790 distributors, 50,000 retailers and 24 warehouses, enabling it to get access to 300 cities and towns. APL's wide reach helps it to save on logistics cost and equips it to provide enhanced services to customers, giving it a meaningful edge over peers.

Exhibit 11: Distributors CAGR of ~10% over FY16-19



Source: Company, Elara Securities Research

Exhibit 12: Entrenched distribution network as on FY19



Source: Company, Elara Securities Research

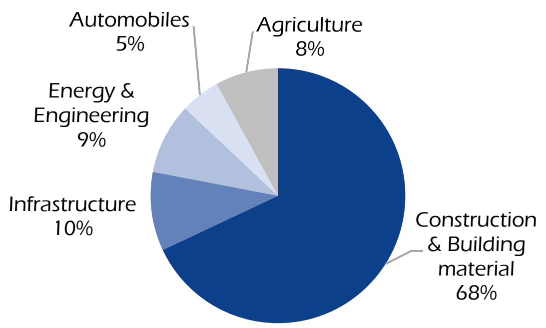
Market share to expand by 600bp over FY19-21E

The domestic ERW pipe industry with an estimated size of ~USD 5bn as on FY19 is largely fragmented, wherein organized firms have a market share of ~60% and the rest is made up of unorganized firms. Despite its fragmented nature and increased competition, APL has established itself as a leading firm of the domestic ERW pipe industry and is gaining market share on a continued basis on the back of 1) rising scale of operations, 2) expanding reach to newer markets, 3) consistent branding as well as aggressive marketing, and 4) improved product offerings. As a result, the company's market share has gone up from ~14% in FY16 to ~18% in FY19. We expect market share to strengthen further from the current ~18% to ~24% by end-FY21E, driven by 1) surplus capacity to tap demand, 2) strengthening of its presence to existing & newer markets with recently added Hyderabad and Raipur units, 3) rising dominance of organized firms with a shift in consumer preferences toward branded products, and 4) low-cost structure.

Ability to cater to diverse sectors

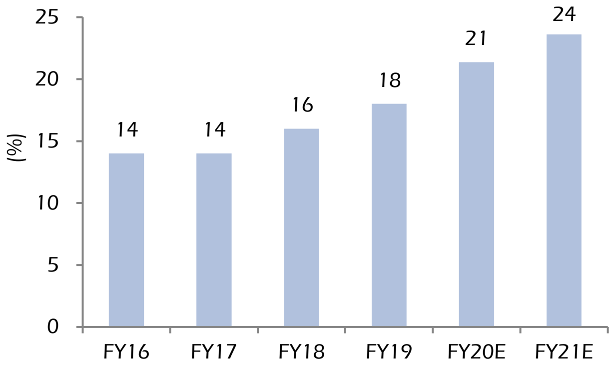
APL's large capacity and pan-India presence with vast distribution network enables it to cater to a range of sectors, which offset sector-specific risks. We believe the company's strong business model will continue to help it capitalize sector-wise growth opportunities and remain immune from any sector-specific unfavorable scenario.

Exhibit 13: Diversified user industry reduces risk



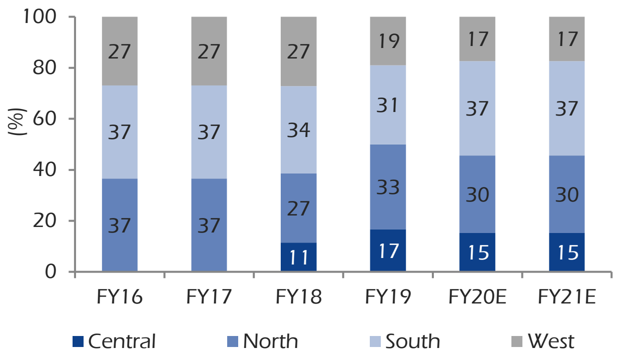
Note; FY19; Source: Company, Elara Securities Research

Exhibit 14: Market share to move up further



Source: Company, Elara Securities Estimate

Exhibit 15: Having capacity in four out of five regions



Source: Company, Elara Securities Estimate

Multiple triggers

- **Equipped with superior technology and strong focus on cost optimization measures**
- **High-margin products share in revenue mix to increase**
- **Margin expansion of 100bp over FY19-21E**

Equipped with superior technology

APL has established itself as a forerunner in terms of introducing new technology in the domestic ERW pipe industry. Its strong focus on technology adoption as well as up-gradation has helped it to outperform its peers. Setting up the galvanizing line, cold saws, high speed mills from Europe and the rotary sizing mills are some key achievements of APL on the technology front in the past couple of years. We believe implementation of DFT across its manufacturing units and access to Galvant technology with its recent acquisition of Apollo Tricoat Tubes are likely to help the company to witness meaningful improvement in overall performance. Typically, DFT may lead to direct material cost savings of 2-10%, whereas products with Galvant technology enjoys 2x margin of current APL products.

Strong focus on cost optimization measures

APL is one of the most cost-efficient firms of domestic ERW pipe industry, owing to its continued investment towards cost optimization measures, such as 1) smart raw materials sourcing with proximity to plants of key raw materials, 2) emphasis on backward integration like setting up 0.2mn-tonne cold-rolling mill in Uttar Pradesh, 3) a gradual increase in use of renewables, 4) focus on upgrading and adopting new technology, and 4) logistics cost optimization with vast distribution network and strategic location of plants to key consuming markets.

Smart raw materials sourcing

Raw materials forms a major cost component in the ERW pipe industry, which constitutes up to 90% of total cost. HR coil (HRC) is the key raw materials for manufacturing ERW pipes. APL plants are strategically close to steel firms, which ensure regular and cost-effective sourcing of HRC. The company buys HRC at a competitive rate (discount of INR 500-1000 per tonne vs peers) as it is one of the largest buyers of HRC in India.

Exhibit 16: DFT and Galvant technology

What lies in DFT and Galvant technology for APL?

Direct forming technology

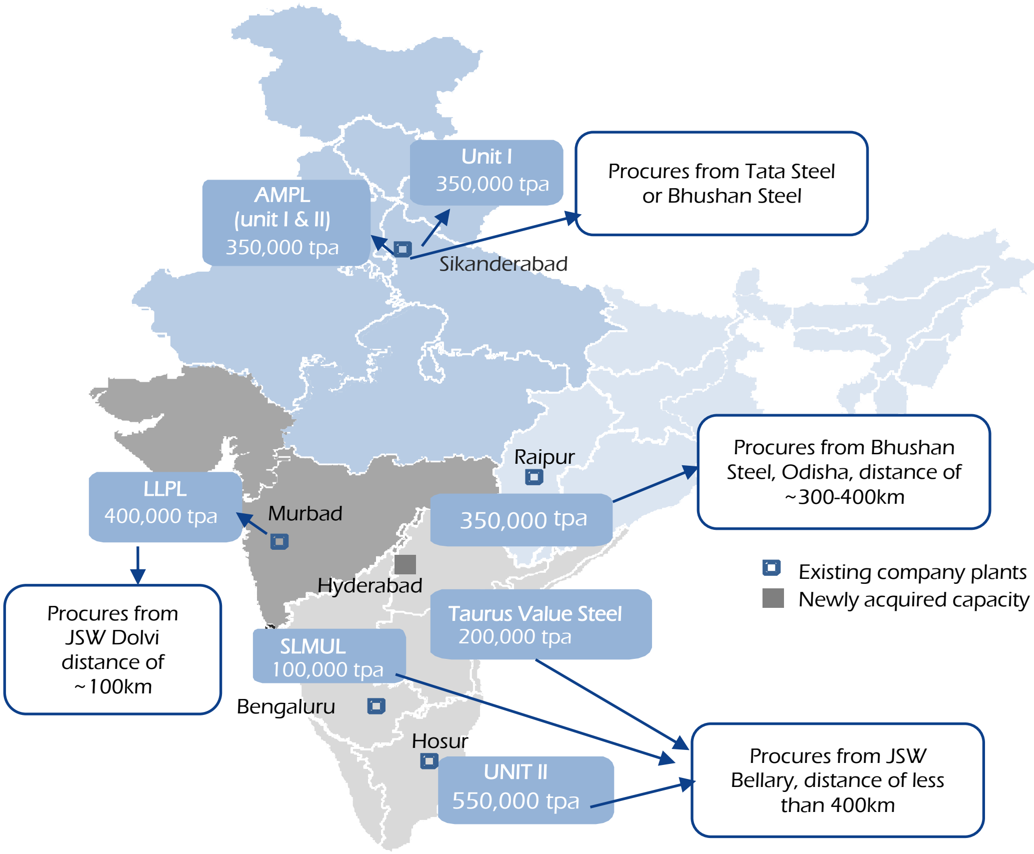
- Direct forming technology (DFT) is a latest global technology which enables manufacturer to produce any customized size of hollow sections of varying shapes, sizes and thickness
- Being completely automatic and computerized process, it provides 1) improved efficiency, 2) higher volume, 3) direct material cost savings of 2-10%, 4) enhanced product offerings, and 4) better margin
- APL implemented DFT in 2016 and currently has three lines at Hosur, two at Murbad, two at Raipur and one at Sikandarabad
- DFT has enabled the company to develop 200 new customized products and provided easy access to tap an array of opportunities across various sectors such as structural & OEM and export markets in the US, Europe, and the Middle East

Galvant technology

- APL, through its wholly owned subsidiary Shri Lakshmi Metal Udyog (SLMUL), has acquired more than 50% stake in Apollo Tricoat Tubes during FY19. The acquisition has an attractive payback period of less than 3-4 years
- Apollo Tricoat Tubes is the first company to introduce the global Galvant technology in India. Its current capacity is around 75,000 tonne per annum and enjoys high margin, which is almost 2x of APL
- Galvant technology provides products tri-layer of protective coating and longevity. Synergy benefits with SLMUL, expanded product portfolio and rise in market share are some expected benefits for APL with the acquisition of Apollo Tricoat Tubes
- SureCoat, DuraCoat and SuperCoat are key product variants and are widely used for electrical conduits, appliances and green houses

Source: Company, Elara Securities Research

Exhibit 17: Proximity of plants to key raw materials provides inward freight advantages



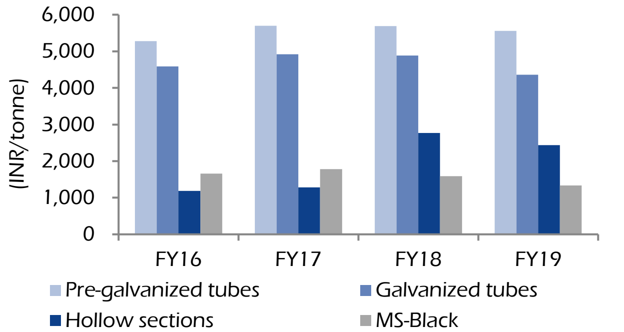
Note: tpa is tonne per annum; Source: Company, Elara Securities Research

Focus on high-margin products

APL offers one of the largest product portfolios among domestic ERW pipe manufacturers and ~70% of the company's product portfolio has limited competition. It makes products in various shapes: round tubes and hollow sections, available in MS Black, pre-galvanized, galvanized, color-coated and API certified grades. Apart from that, it has strengthened its product portfolio in the past two years by entering into manufacturing prefabricated structural products, such as door frames, window frames, handrails, and small & narrow sections.

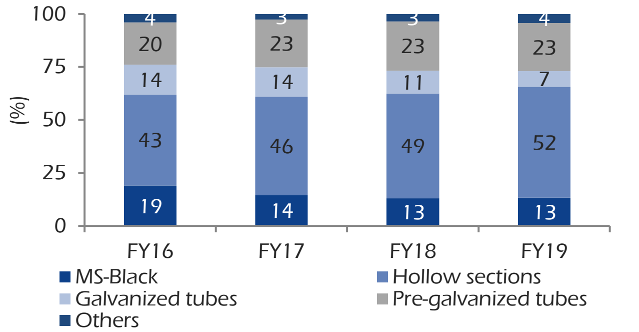
These prefabricated products are useful in constructing low-cost houses and are being considered as substitutes to traditionally used materials, such as wood, concrete and aluminum. Further, APL has started manufacturing color-coated, designer and dynamically balanced tubes. APL has gradually reduced its presence in low margin products like MS Black (FY19 EBITDA per tonne of INR 1,336) with decline in revenue mix from 19% in FY16 to 13% in FY19 and has increased its exposure to hollow section pipes (FY19 EBITDA per tonne of INR 2,436) with rise in revenue mix from 43% in FY16 to 52% in FY19.

Exhibit 18: Pre-galvanized tube with the highest EBITDA per tonne



Source: Company, Elara Securities Research

Exhibit 19: Revenue mix skewed toward high margin products



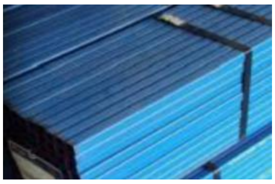
Source: Company, Elara Securities Research

Exhibit 20: Brief overview of key product categories

Product	Description
Hollow sections 	▪ Possess high tensile capacity, compressive strength, rigidity & fire resistance. Available in various shapes, sizes and finishers. Most common among them include rectangular hollow sections (RHS) and square hollow sections (SHS) ▪ One of the fastest-growing segments in pipes and tubes being widely used in construction, machinery, automotive, transport and agricultural sectors. Constitutes ~52% of total revenue as on FY19
Pre-galvanized tubes 	▪ Manufactured by using pre-galvanized sheets which provides durability, stability and sustainability without atmospheric corrosion. ▪ Being used for fencing, cabling & ducting, automotive (bus body) and scaffolding. Constitutes ~23% of total revenue as on FY19
Galvanized tubes 	▪ Galvanized tubes are pre-manufactured steel tubes dipped in molten zinc. These pipes are highly corrosion resistant, light in weight, easy to handle during transport and easy to join. ▪ Varied applications such as piping systems, power, engineering and refineries. Constitutes ~7% of total revenue as on FY19
MS Black Pipes 	▪ Manufactured using the high grade mild steel ▪ Owing to low maintenance, these tubes are used in boilers, power transmission and gas distribution system. Constitutes ~13% of total revenue as on FY19

Source: Company, Elara Securities Research

Exhibit 21: Key prefabricated products offered by APL

Double door frame section	Single door frame section	T Section	L Section
			
Narrow sections		Handrail	Elliptical tube
			
Paint Coated	Pipe Dimensions	D Shape	Hand Rail
			

Source: Company presentation

Margin expansion of 100bp by FY21E

We expect margin to expand by 100bp to 6.7% over FY19-21E, led by 1) improved operating leverage & higher contribution from direct forming technology (DFT) (20bp margin contribution), 2) better inventory management (60bp margin contribution), and 3) improved realization with continued endeavor for value-added products (20bp margin contribution)

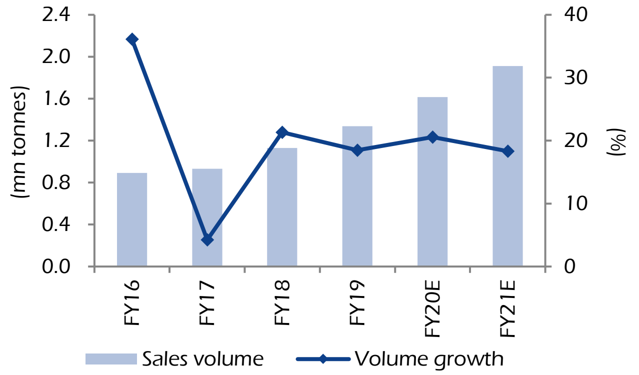
Improving fundamentals

- **EPS to grow at a CAGR of ~49%, led by strong volume growth and margin expansion**
- **Net debt-equity to decline from 0.8x to 0.4x by FY21E; ROE to expand by 765bp over FY19-21E**
- **Initiate with Buy with a TP of INR 2,267, implying ~41% upside**

Revenue CAGR of ~21% over FY19-21E

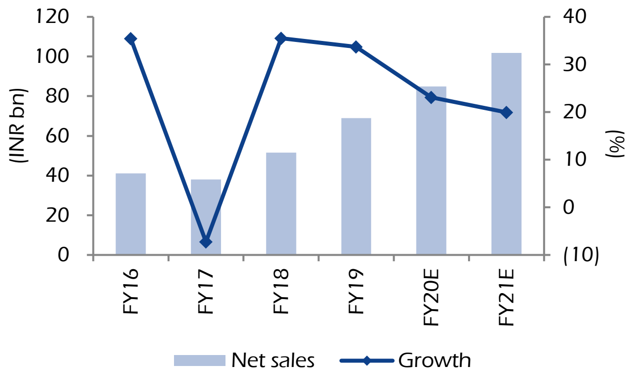
APL has registered a volume CAGR of ~14% over FY16-19 on the back of aggressive capacity addition and strong focus on expanding market reach. We expect surplus capacity, strong brand positioning and likely improvement in industry demand to result in a volume CAGR of ~19% over FY19-21E. Further, we believe robust volume growth will continue to be a key driver of top-line growth and thus expect a revenue CAGR of ~21% over FY19-21E.

Exhibit 22: Volume CAGR of ~19% over FY19-21E



Source: Company, Elara Securities Estimate

Exhibit 23: Strong volume to drive revenue growth

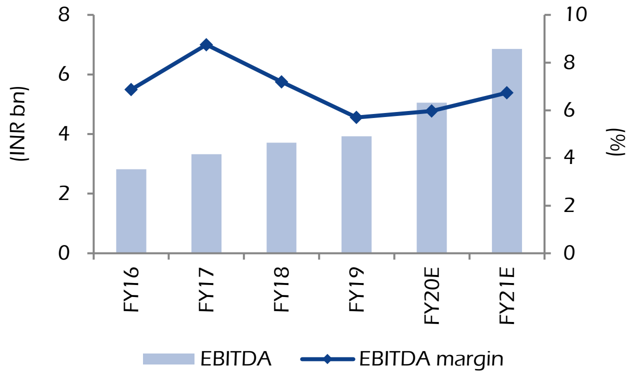


Source: Company, Elara Securities Estimate

Improving profitability

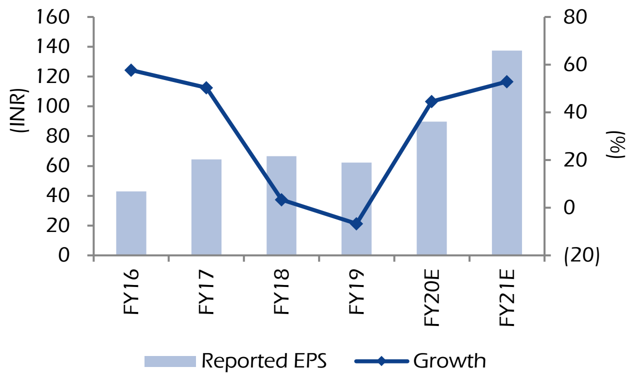
We expect margin to expand by 100bp to 6.7% over FY19-21E, resulting in an EBITDA CAGR of ~32% to INR 6.8bn over FY19-21E, led by margin expansion and revenue growth. With expected uptick in deleveraging efforts by the company and improved operating performance, EPS of the company is expected to grow at a CAGR of ~49% over FY19-21E.

Exhibit 24: Higher efficiency and improved product mix to bolster EBITDA



Source: Company, Elara Securities Estimate

Exhibit 25: EPS CAGR of ~49% over FY19-21E

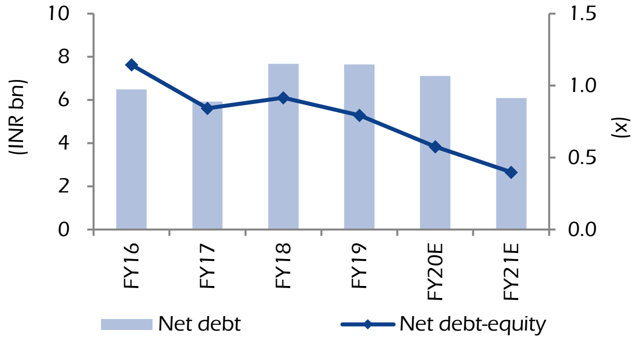


Source: Company, Elara Securities Estimate

Balance sheet to strengthen

After extensive capacity additoin in the past three years, we believe APL will not undertake any new project expansion in the near term as the company already has surplus capacity (FY19 sales volume stood at 1.3 mn tonnes while present capacity stands at 2.3 mn tonnes). Therefore, we believe the absence of any major capacity expansion projects in the near term and improved performance will help to generate higher free cash flow of INR 3.2bn over the next two years and thus, gradual deleveraging of balance sheet. We expect a decline in the net debt-equity ratio from 0.8x in FY19 to 0.4x in FY21E.

Exhibit 26: Gradual reduction in debt

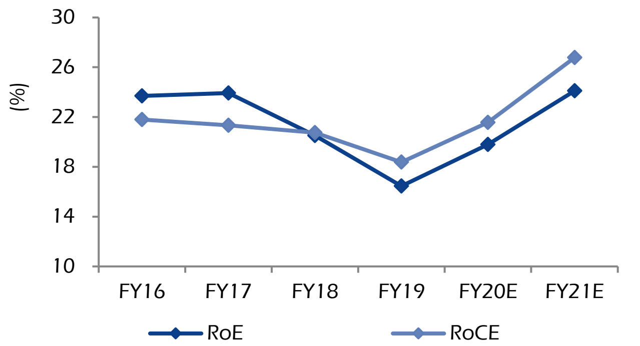


Source: Company, Elara Securities Estimate

Return ratios to improve

We expect strong earnings growth and higher asset turnover ratios to lead to healthy improvement in return ratios in the upcoming years. We expect ROE to expand by ~765bp to 24.1% over FY19-21E and a 840bp expansion in ROCE to 26.8% over FY19-21E.

Exhibit 27: Encouraging improvement in return ratios



Source: Company, Elara Securities Estimate

Efficient working capital management

APL's strong focus on working capital management has helped it to witness meaningful improvement in the working capital cycle over FY16-19. Working capital days have come off, from 51 days in FY16 to 33 days by end-FY19, and we expect further improvement going ahead.

Exhibit 28: Working capital management improves

	FY16	FY17	FY18	FY19	FY20E	FY21E
Receivable days	20	28	31	29	28	27
Inventory days	55	48	43	42	41	40
Payable days	24	40	28	38	37	37
Average working capital days	**51**	**36**	**46**	**33**	**32**	**30**

Source: Company, Elara Securities Estimate

Initiate with a Buy and TP of INR 2,267

At a CMP of INR 1,610, the stock trades at 6.5x FY21E EV/EBITDA and 11.7x FY21E P/E, which is below five-year average EV/EBITDA of 8.7x and P/E of 16.3x.

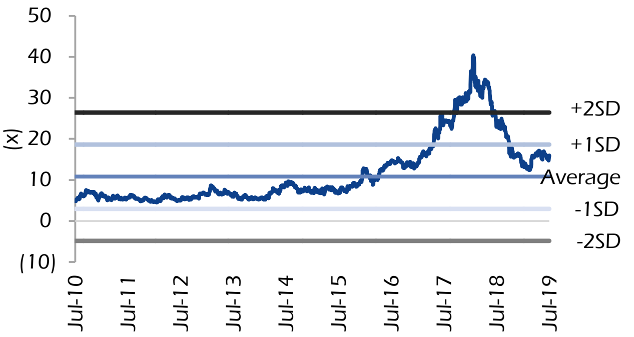
We initiate on APL Apollo Tubes with a **Buy** rating and a price target of INR 2,267, implying ~41% upside from the current levels. Our TP is based on 16.5x FY21E P/E, which is in line with past five-year average of 16.3x. We highlight that fundamentals in FY21 are likely to be much stronger than the past five years. We expect FY21E ROE of 24.1% vs a five-year average of 19.7%, while FY21E debt-equity ratio of 0.4x vs 1.0x in the past five years. We believe the stock deserves a premium valuation considering its industry-leading capacity, superior return ratios and strong business outlook.

Exhibit 29: Target multiple in line with five-year average

(INR mn)	FY21E
Target P/E	16.5
EPS (INR)	137.4
TP (INR)	**2,267**
CMP (INR)	1,610
Upside (%)	41

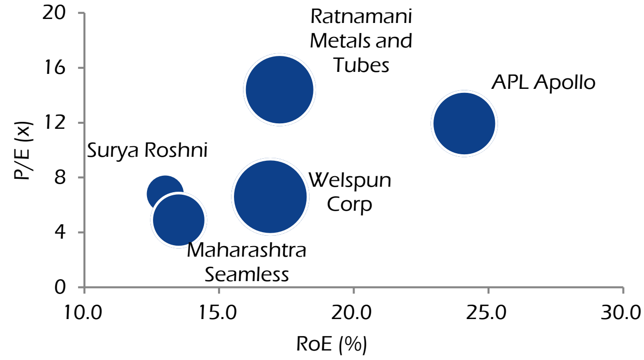
Note: pricing as on 5 July 2019; Source: Elara Securities Estimate

Exhibit 31: Five-year average P/E stands at 16.3x



Source: Bloomberg, Company, Elara Securities Estimate

Exhibit 32: ROE to remain higher than other steel pipe companies



Note: ROE & P/E for FY21E; Source: Bloomberg

Exhibit 30: Key assumptions

	FY16	FY17	FY18	FY19	FY20E	FY21E
Sales volume ('000 tonne)						
MS Black	194	151	164	198	228	273
Hollow sections	426	475	614	766	935	1,122
Galvanized tubes	115	117	111	92	112	128
Pre-galvanized tubes	159	189	241	283	339	387
Realization per tonne (INR)						
MS Black	33,776	37,081	42,200	47,835	48,553	49,038
Hollow sections	34,651	37,846	42,987	48,901	50,368	51,375
Galvanized tubes	42,194	45,941	51,786	57,278	59,111	59,702
Pre-galvanized tubes	42,027	46,291	51,539	57,319	59,153	59,745
EBITDA per tonne (INR)	**3,152**	**3,574**	**3,283**	**2,933**	**3,134**	**3,590**

Source: Company, Elara Securities Estimate

Fundamentals better than peers

APL has better working capital management as compared to peers at 33 days against industry average of 103 days in FY19. The company is able to utilize its capital more efficiently than its peers which is reflected in the return ratio as ROE of APL at 16.5% in FY19 is well above peers' average of 9%.

Increased competition to restrict pricing power

The ERW pipe industry is highly fragmented, with a 40% market share with unorganized firms. Lower capex requirement and higher turnover make ERW business attractive for new firms to enter the industry, and, thus, poses a challenge for existing companies to face increased competition and limited pricing power.

Exhibit 33: APL with the lowest working capital cycle in the industry

Company	Ticker	Rating	Mcap (INR bn)	CMP* (INR)	Target (INR)	Upside (%)	EBITDA margin (%)		Working capital days		Interest coverage ratio (x)	
							FY18	FY19	FY18	FY19	FY18	FY19
APL Apollo Tubes	APAT IN	Buy	39.1	1,610	2,267	41	7.2	5.7	46	33	4.0	3.0
Surya Roshni	SYR IN	Not Rated	12.1	223	NA	NA	7.1	6.2	86	83	1.7	1.5
Maharashtra Seamless	MHS IN	Not Rated	28.4	424	NA	NA	14.4	21.7	141	132	55.1	35.6
Jindal Saw	JSAW in	Not Rated	26.1	82	NA	NA	14.3	13.2	171	118	2.3	2.0
Welspun Corp	WLCO IN	Not Rated	38.3	144	NA	NA	9.7	6.6	60	77	2.1	1.8
Ratnamani Metals and Tubes	RMT IN	Not Rated	46.3	992	NA	NA	15.2	14.8	202	106	32.2	23.3
Average (excluding APL)							12.1	12.5	132	103	18.7	12.8

Note: *pricing as on 5 July 2019; Source: Bloomberg, Company, Elara Securities Research

Exhibit 34: APL with the highest ROE in the industry

Company	ROE (%)		ROCE (%)		Net D/E (x)	
	FY18	FY19	FY18	FY19	FY18	FY19
APL Apollo Tubes	20.5	16.5	20.7	18.4	0.9	0.8
Surya Roshni	10.8	11.0	8.4	9.1	1.0	1.0
Maharashtra Seamless	6.9	8.5	6.9	8.1	(0.6)	1.1
Jindal Saw	6.7	8.2	6.1	8.1	0.7	0.6
Welspun Corp	5.6	(0.5)	7.0	0.9	0.1	0.8
Ratnamani Metals and Tubes	12.2	17.9	12.1	17.7	0.0	(0.2)
Average (excl. APL)	8.4	9.0	8.1	8.8	0.3	0.7

Source: Bloomberg, Elara Securities Research

Investment risks

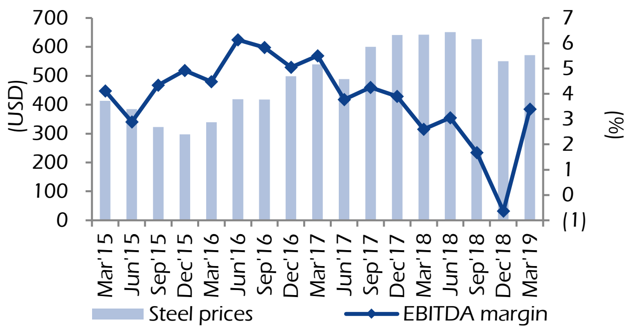
Fluctuations in steel prices may drag margin

Raw material cost is a major cost component for the ERW pipe industry and constitutes up to 90% of total cost. HR coil is the key raw material for manufacturing of ERW pipe and sharp fluctuation in HR coil prices in a short period of time can impact profitability of APL. For e.g., a sudden fall in HR coil prices during Q3FY19 forced APL to book an inventory loss of INR 417mn, which led to a sharp fall in EBITDA margin to 3.7% in Q3FY19 vs 6.9% in Q3FY18.

Slower-than-expected demand pickup

APL has a well-diversified presence to different sectors, from modern infrastructure, such as airports, mall & ports to building materials, construction, automobile, agriculture and energy. Any slowdown in these sectors may have a direct bearing on overall sales volume.

Exhibit 35: HR coil movement plays important role in APL margin profile



Source: Bloomberg, Elara Securities Research

Threat of substitution may lead to lower demand

Over the past few years, PVC pipe has started to gain strong traction on account of its light weight, low pressure-handling capacity and low cost. Consequently, PVC pipes are substituting traditionally used GI pipes in the agriculture industry, especially in plumbing and irrigation. GI pipes have one of the highest margin products and threat of substitution in this segment can impact overall profitability.

Annexure

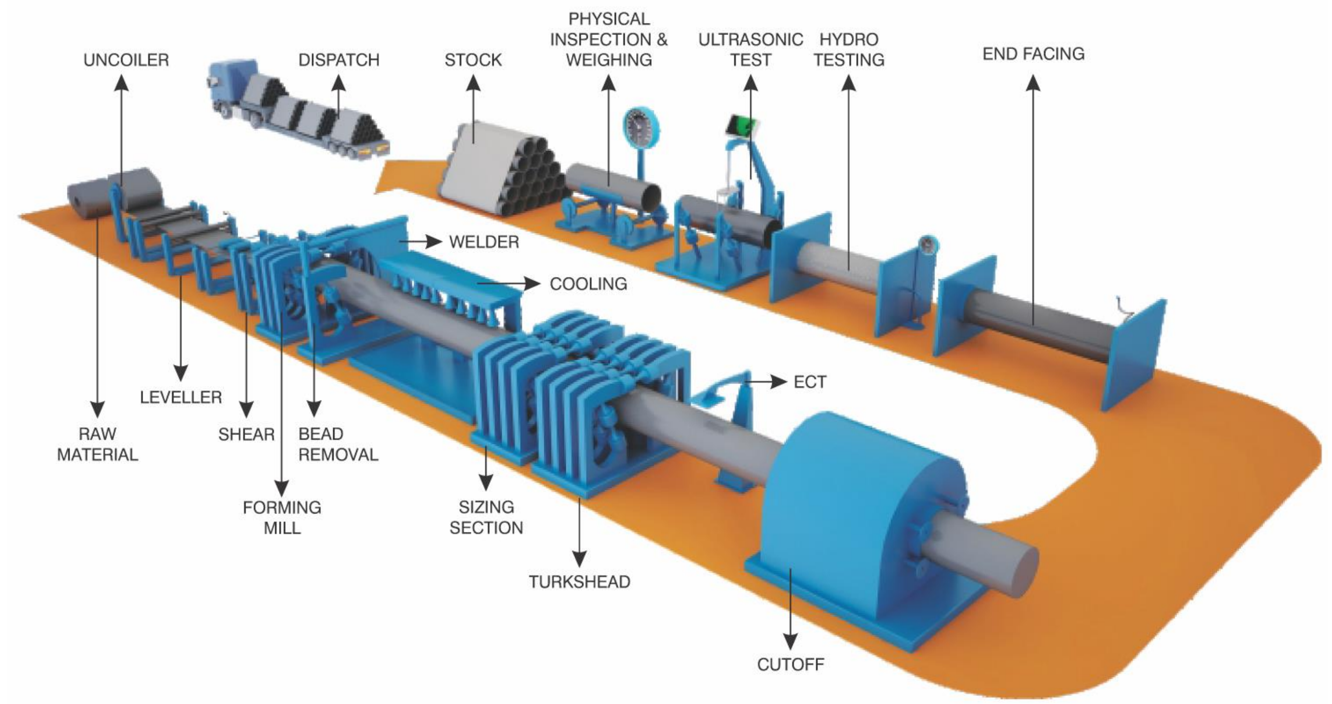
Exhibit 36: Structure of India's steel pipe industry

India's steel pipe industry

Pipe type	Seamless pipes	LSAW pipes	HSAW pipes	ERW pipes
Raw material used	Billets	Steel plates	HR coils	HR coils
Size	0.5" to 14"	16" to 56"	18"to 120"	0.5" to 22""
Key India firm	Jindal Saw Maharashtra Seamless Indian Seamless Metal Tubes (ISMT)	Jindal Saw Welspun Corporation Man Industries	Jindal Saw PSL Welspun Man Industries	APL Apollo Jindal Pipes Maharashtra Seamless Welspun Corporation
Applications	Oil & Gas, engineering, automotive and power	Oil & Gas and water transportation (high pressure applications)	Water transportation, construction	**Traditional:** auto, power, city gas distribution, WSS, engineering **New age:** modern infra such as metros, malls, airports, irrigation structures, prefabricated structures

Source: Company, Elara Securities Research

Exhibit 37: Manufacturing process of ERW pipe



Source: Company, Elara Securities Research

Exhibit 38: ERW pipe plays an important role in the building segment

1	Structural steel	2	Fencing	3	Hand railing	4	Roofing	5	Scaffolding
6	Door frame	7	Window frame	8	Ducting	9	Furniture	10	Fire fighting

Source: Company, Elara Securities Research

Pipes

Company Description

APL Apollo Tubes (APL) was incorporated in 1986. With an installed capacity of 2.3mn tonnes, it is the largest manufacturer of ERW pipes & tubes in India. It has a pan-India presence with eight manufacturing units across the central, northern, southern and western regions. The company sells products across 300 town & cities in India; apart from that, it exports to 20 countries. Further, its strategic location of plants with proximity to raw materials and strong supply chain mechanism with 24 warehouses, 790 dealers & distributors and 50,000 retailers provide an edge compared to its competitors

Board of Directors & Management

Sanjay Gupta, Executive Chairman

Sanjay Gupta has over two decades of experience in various steel industry segments. He has been Executive Chairman since April 1, 2012.

Ashok K Gupta, Managing Director

Ashok Gupta has three decades of experience in the steel industry and has worked with major companies, such as SAIL, Bhushan Steel, LN Mittal Group and Jindal. He joined the company in 2011 and was appointed MD in February 2012. He has a master's degree in Physics and a post-graduate diploma in Business Administration from AIMA.

Romi Sehgal, Director

Romi Sehgal has 35 years of experience in the steel and tubes industry. He has been associated with the company since 2008 and was appointed as Director in August 2016. Before joining APL Apollo, he worked at Atlas Steel Tubes, Atma Steel Tubes, Bharat Steel Tubes and for 13 Years at Gallium Industries.

Exhibit 40: Business matrix

Installed capacity	Eight manufacturing units with total capacity of 2.3mn tonne pa
Plant location	Sikandarabad, Uttar Pradesh (3 units), one unit each at Hosur (Tamil Nadu), Bengaluru (Karnataka), Hyderabad (Telangana), Murbad (Maharashtra) and Raipur (Chhattisgarh)
Product offerings	Hollow section, pre-galvanized tube, galvanized tubes and black round pipes. Total product offerings augmented to 1,100+ varieties
Key brands	*Apollo Coastguard, Fabritech, Bheem* and *Agritech*
Distribution network	24 warehouses, 790 dealers & distributors and 50K retailers

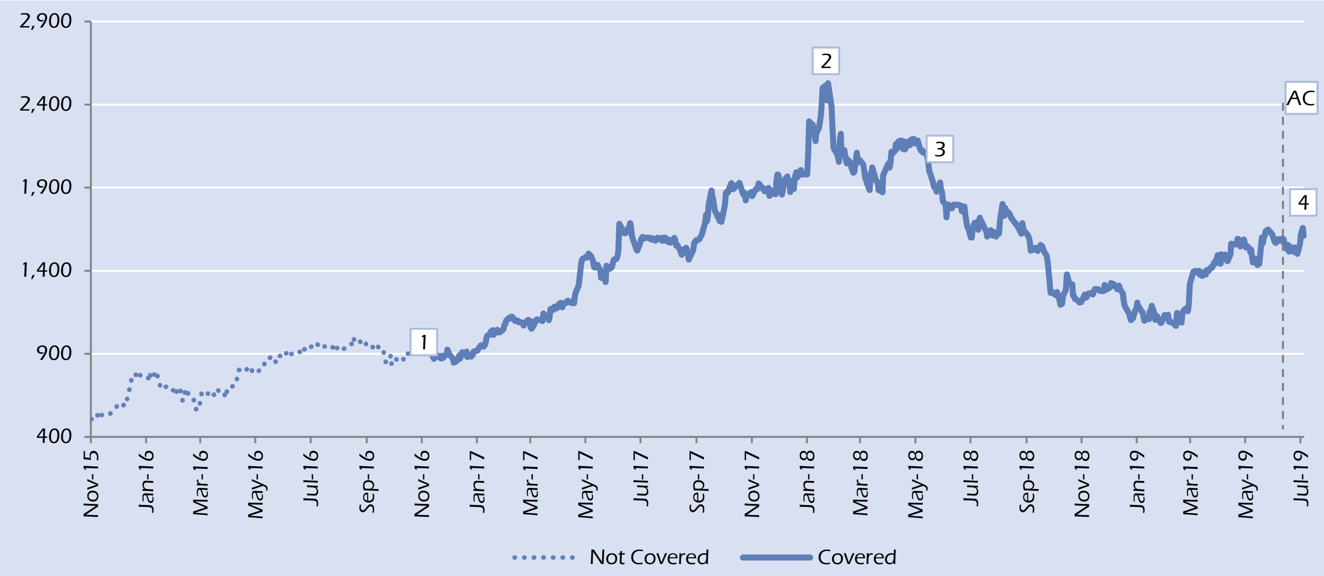
Source: Company, Elara Securities Research

Exhibit 39: Key milestones

Year	Milestone
1986	Started operations by setting up first unit in Sikandarabad (UP)
1994-2002	Listed on exchanges and commissioned a galvanizing unit, new tube mill and modern gallium high speed mills
2003-04	Developed in-house hollow sections and launched pre-galvanized pipes
2007-08	Achieved pan-India status by acquiring Apollo Metalex and Shri Lakshmi Metal Udyog
2009-10	Commissioned Hosur unit. Started coil galvanizing for GP pipes
2011-12	Name changed from Bihar Tubes to APL Apollo Tubes. Acquired Lloyds Line Pipes near Mumbai
2013-14	Launched door & window frames and railing tubes. Developed and procured CRFH coils from JSW steel to expand product range
2016-17	Commissioned Greenfield capacity at Raipur. Established DFT lines at its Raipur, Hosur and Murbad plants
2018	Acquired equity stake in Apollo Tricoat Tubes
2019	Completed acquisition of Hyderabad based Taurus Value Steel & Pipes, having capacity of 0.2mn tonnes pa

Source: Company, Elara Securities Research

Coverage History



	Date	Rating	Target Price	Closing Price
1	4-Nov-2016	Buy	INR 1,596	INR 925
2	30-Jan-2018	Accumulate	INR 2,569	INR 2,255
3	29-May-2018	Buy	INR 2,455	INR 1,932
4	5-Jul-2019*	Buy	INR 2,267	INR 1,610

*AC: Analyst change

Guide to Research Rating

BUY	Absolute Return >+20%
ACCUMULATE	Absolute Return +5% to +20%
REDUCE	Absolute Return -5% to +5%
SELL	Absolute Return < -5%

Pipes

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