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DEMOCRATIZING WEALTH CREATION

VALUE PICK

CHASING VALUE, NOT PRICES

December 2019

Company Name	:	**APL APOLLO TUBES**
BSE Code	:	**533758**
Time Duration	:	**1 year**
CMP	:	**₹1615.00 (as on 12 December, 2019)**
Target Price	:	**₹1970**

Value Pick for the month of December 2019 is APL Apollo Tubes, the largest producer of Electric Resistance Welded (ERW) steel pipes in India. Also, it is one of the top five steel tube manufacturers globally. The company has around 11 plants across the country with a capacity of 2.5 million tons. APL Apollo's installed capacity is around 2.3 million MTPA. Moreover, the Tricoat manufacturing line of 250,000 MTPA has taken its total installed capacity to 2.55 million MTPA. The company's product portfolio includes hollow sections, black round pipes, GI and GP pipes. These products are used in various industries like construction, infrastructure projects, energy, and engineering. The company is the market leader in the structural steel tube sector with an estimated market share of 40 per cent as of Q2FY20. The company has 790 direct distributors/dealers and 50,000 retailers.

The healthy demand outlook for ERW pipes : There are many macro factors that are expected to push demand for ERW pipes. The government's impetus for infrastructure development, increasing disposable income of rural and higher construction activity in the country bodes well for the ERW pipes. Further, a shift in demand from unorganised to organised players is also likely to add to the demand going forward. Notably, the development of new-age applications such as agricultural implements, solar tracking systems, gym/sports equipments, construction equipment and automobile application would also aid in boosting volume for the company. Besides, APL Apollo's products are the best substitute for wood, thus, giving a healthy demand outlook. Taking these into consideration, the demand for ERW pipes is expected to clock high single-digit growth in the coming years.

Well poised to reap benefit from growing demand : For the last two years, the company has been on Capex mode. It resulted in the overall capacity of 2.5 million tons as against 1.3 million tons capacity, which it had two years back. The company has also acquired the plants of Shankara and Apollo Tricoat. These acquisitions would help APL Apollo to move up the value chain in existing high margin pre-galvanised (GP) and galvanised (GI) pipes segments and also foray into a new, value-added segment such as doors & designer pipes which are high margin businesses. Going forward, the company is unlikely to increase capacity and will focus predominately on scaling-up the volume. The company is also increasing its offering; from building material space through developing products for fencing, hand-holding, railings, scaffolding, ducting, furniture, fire fighting, windows, and door frames. Considering a strong demand for the ERW pipes and the company's leadership positioning, we believe the company is well-poised to clock a strong growth in the coming years.

Introduced first of its kind Innovative technology in India

With its vast experience, the company has been investing heavily in the new technology and it is known for the early adoption of innovative and new technology. APL is the pioneer company to offer pre-galvanised and colour-coated pipes. Thus, in line with its culture of adoption of new technology in 2016, the company introduced direct forming technology (DFT). In India, APL is the only company that uses this technology which helps it to reduce time and cost. In the conventional process, round pipes are formed first and then converted to square or rectangular, but, DFT enables the direct formation of hollow pipes of various shapes and sizes (square and rectangular). With the adoption of this technology, APL has moved up one step ahead from its peers and DFT would enable APL to execute customise orders, 2-8 per cent cost-saving through elimination of wastage at the edges when round pipes are converted into square /rectangular pipes; huge time saving as with DFT, company can execute smaller orders in ~20 minutes as against 4-24 hours time taken due to the traditional method where multiple steps were involved.

Strong distribution network and increasing promotional activities : Over the years, APL Apollo has increased its presence in various parts of the country through 790 distributors as of FY19 from 150 in FY10. Furthermore, the company has around 50,000 retailers in approximately 300 cities which are far more than its close peer. Through this distribution

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channel, the company generates nearly 85 per cent of its revenue. Also, APL's manufacturing facilities are spread across all geographies and it has balanced its capacity across the region efficiently (South-30 per cent of total capacity, North-28 per cent, West-22 per cent and Central- 20 per cent). The company also has 29 warehouses that ensure seamless and effective supply. By increasing presence, the company has been able to penetrate in untapped domestic markets and increase awareness of its product. The company is also spending on promotional activities like advertisement through television, hoardings, etc. For these promotional activities, the company has chosen Amitabh Bachchan as a brand ambassador.

Financial performance : In the last fiscal year (2018-19), the company witnessed 19 per cent YoY growth in sales volume to 1.34 despite challenging market conditions. The net sales for the year were at Rs 7152.3 crore, representing 34 per cent YoY growth. Due to inventory loss, the company's EBITDA registered ~7 per cent YoY growth to Rs 404.55 crore. The EBITDA margin for the year was at 5.65 per cent. PAT for FY19 dipped ~6 per cent YoY to Rs 148.3 crore.

In the recently concluded quarter (Q2FY20), the company's net sales were almost stable at Rs 1,583.81 crore vs 1631.7 crore in Q2FY19. Due to fluctuation in the steel prices, the company witnessed an inventory loss which resulted in ~17 per cent YoY fall in EBITDA to Rs 72 crore with a corresponding margin contraction of 73 bps. EBITDA margin for the quarter was at 4.37 per cent. However, due to tax benefit, APL's profit after tax jumped by nearly 125 per cent YoY to Rs 59.8 crore. PAT margin improved to 3.63 per cent in Q2FY20.

Valuation & outlook : We believe that the capacity addition is likely to enrich the company as demand for the ERW segment is expected to increase. Going forward, the company is expected to witness lower input, operating costs and transportation cost as a benefit of economies of scale starts kicking in. With a focus on innovative products and new technology in the production process, the company is well-poised to outpace industry growth. In terms of valuation, the stock of APL Apollo is available at 22x P/E multiple on TTM earnings which is close to its five-year median P/E of 21.4x. Considering all these, we recommend a BUY on the stock with a target of Rs 1970, representing a potential upside of 22 per cent.

Inc/Exp Statement(Consolidated) (Rs in Crore)

Description	201903	201803	201703	201603	201503
Net Sales	7152.32	5334.77	3923.90	4213.59	3138.27
Total Income	7168.20	5342.78	3929.87	4223.86	3142.78
Total Expenditure	6763.65	4963.73	3590.93	3931.93	2956.66
PBIDT	404.55	379.05	338.94	291.93	186.12
PAT	148.25	158.13	152.11	100.57	63.75
Dividend %	140.00	140.00	120.00	100.00	60.00
Adj. EPS(Rs)	62.16	66.64	64.48	42.91	27.20

Quarter On Quarter (Consolidated) (Rs in Crore)

Particulars	201909	201906	Q on Q Var%	201809	Y on Y Var%
Net Sales	1583.81	1993.61	-20.56	1631.67	-2.93
Total Expenditure	1575.30	1946.61	-19.07	1604.25	-1.80
PBIDT (Excl OI)	71.98	124.99	-42.41	86.22	-16.52
PAT	59.83	52.13	14.77	26.68	124.25
PBIDTM% (Excl OI)	4.37	6.03	-27.53	5.10	-14.31
PBIDTM%	4.65	6.25	-25.60	5.21	-10.75
PATM%	3.63	2.52	44.05	1.58	129.75
Adj. EPS(Rs)	22.73	21.35	6.46	11.24	102.22