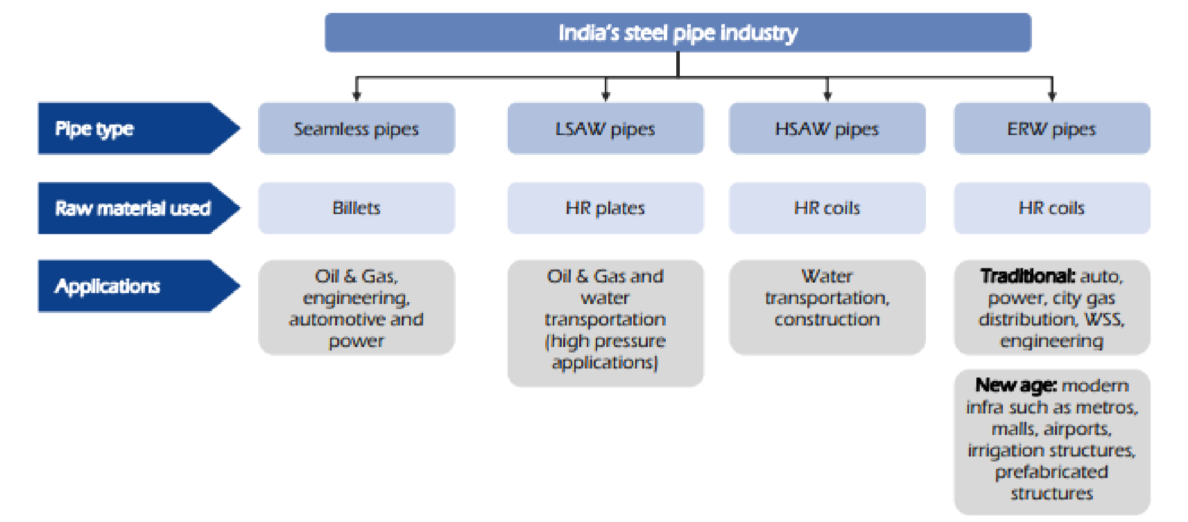
APL Apollo Tubes

BRIEF –

The company is involved in manufacturing of electric resistance welded steel tubes & pipes. The ERW pipes are used in engineering, automobiles, gas distribution, modern infra, airports, metros & sprinklers. It also provides pre-galvanized tubes that are used in fencing, cabling and ducting, automotive, greenhouse structures, gates and grills, electrical conduit, and scaffolding applications; and hot dipped galvanized pipes, tubes, and steel pipes used in the underground piping, over ground piping, power, refineries, scaffolding, airports, metro stations, fire-fighting systems, and HVAC applications. In addition, the company offers flat/oval capsule sections, handrails, d-sections, elliptical sections, narrow sections, window sections, and taper sections, as well as modular door solutions. It also exports its products to approximately 20 countries worldwide.

INDUSTRY –

Exhibit 33: Structure of India's steel pipe industry



Source: Company, Elara Securities Research

There are four types of steel pipes that are used, depending on strength, pressure-holding capacity and manufacturing processes. They are:

1. **Seamless pipes** - the pipe is manufactured without a seam or any welding. It has the highest pressure-handling capacity, able to withstand higher temperatures and have stress resistance. They are primarily used in oil & gas exploration and production.

2. **Longitudinal submerged arc welded (LSAW) pipes** - These pipes are manufactured using hot rolled (HR) plates and welded on both sides, which increases its pressure-handling ability compared to HSAW pipes. Given strength and toughness, these pipes are largely used in long-distance transport of oil & gas. L SAW pipes have superior margins than H SAW pipes, EBITDA margins are 20-25% in the L SAW segment.

3. **Helical submerged arc welded (HSAW) pipes** - These spirally, one-sided welded pipes are manufactured using HR coils. They are generally used to transport water & sewage and in the construction segment.

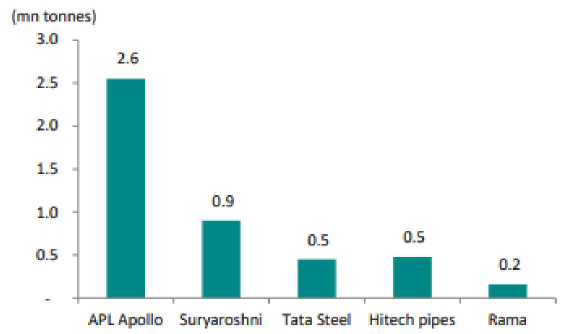
4. **Electrical resistance welded (ERW) pipes** - These pipes are welded on the straight seam using high frequency welding process. They have the lowest pressure-holding capacity. Recently, they have found applications in the form of structurals in the construction and modern infrastructure segments.

The company operates in the ERW pipes segment, hence let’s focus on ERW pipe market.

ERW pipe market -

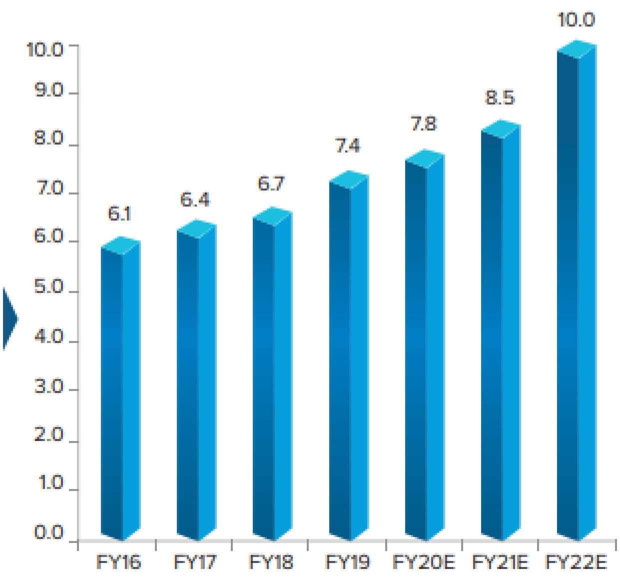
Total market size – The domestic ERW Steel Pipes industry demand is expected to touch 10 mt by 2022 with an approximate market size of around ₹ 600 billion. APL Apollo tube is dominant player in this segment with installed capacity of 2.6 MTPA (As of Q1 FY 2022) followed by Surya Roshni at distant 900,000 TPA for ERW segment (as of Q1 FY 22).

Exhibit 11: APL is by far the largest ERW pipe maker



Source: Company, IDBI Research

ERW Pipes industry growth trend (in million tonnes)



E: Estimated Growth

Source - surya roshni annual report

Company -

The company is leader in the segment with highest capacity & has aggressively increased in a business with low (7-10%) EBITDA margin sector. With its distribution network of 800 distributors & 10 manufacturing plants spread across Pan-India provides it with an edge in distribution & transportation cost. With capacity expansion, company has also increased SKU's in order to provide end retailer with higher number of products under one brand.

The company has expanded its presence through organic & inorganic acquisition & expansion. It acquired companies –

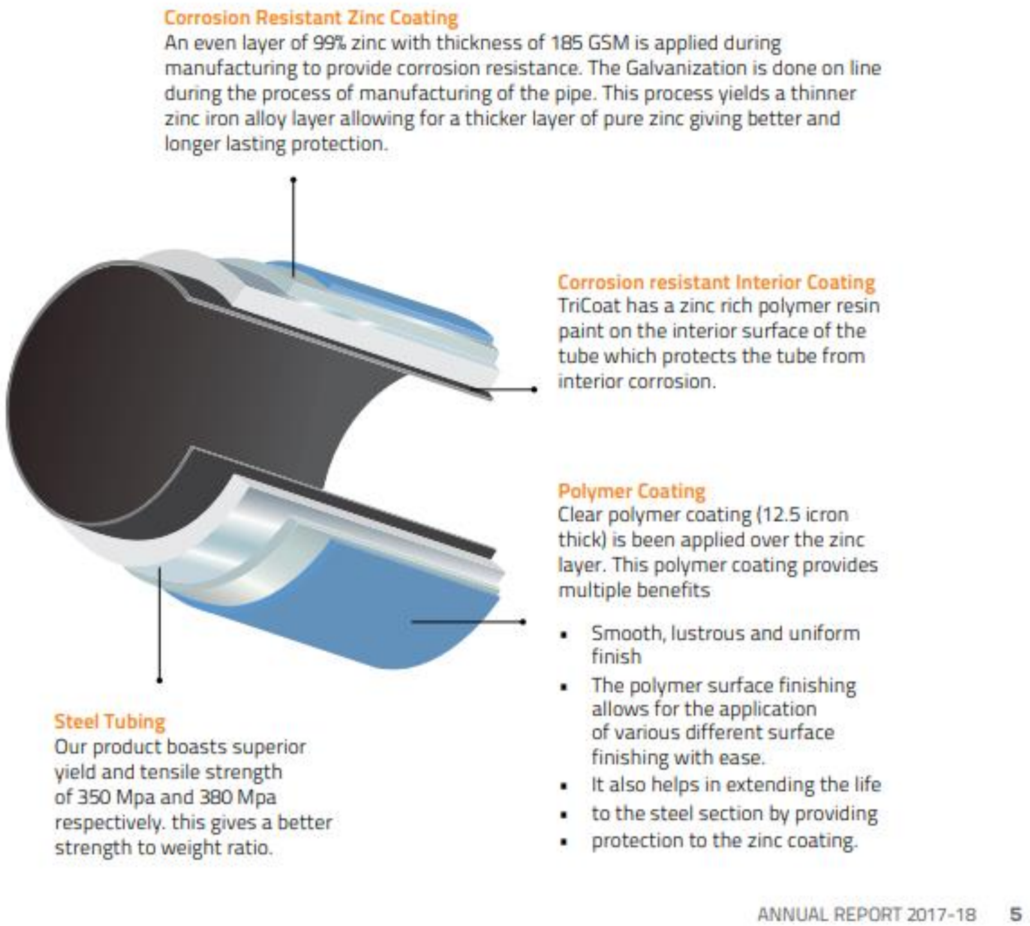
1. Lloyds pipe located in Maharashtra to expand in West,
2. Taurus value steel owned by Shankara building product located in Hyderabad in the east,

3. Apollo metalex to expand located in UP in north
4. Shri Lakshmi Metal Udyog located in Bangalore to expand in south

It has been successful in turning around all companies except Taurus as it was acquired only in 2020. The organic expansions have augured well for the company.

It has been at the forefront of innovation in the sector & bringing latest technology to India. In FY 2016, company started investing in Direct forming technology (DFT) which can manufacture custom sizes according to needs of customer with less disruption in production time which is 30 minutes for DFT versus 3-4 hours for traditional technology. Also, due to lower time wasted in DFT, it can manufacture lower tonnes of order compared to traditional technology. The DFT investment has been beneficial for company as earlier products were imported or customers used generic available sizes. As product technology wasn't available till recently (now Surya Roshni has entered with small scale compared to company in DFT), the company earned higher margins on customized order sizes.

The company has created brands for generic products like Apollo Chaukhat, Apollo plank, Apollo signature, etc which has helped it fight itself against unorganized players & create a standard quality product with higher EBITDA margins for the company. It also brought in tricoat technology which wasn't available in India & is also a value added product for the company.



The borrowings both short & long term were on the higher side as company was able to fund its capex through internal accruals somehow, but additional working capital loan was required to grow its business which has changed post covid. After April 2020, company has reduced its credit provided to distributors & sells on cash basis or channel finance which has helped it reduce its working capital loans. It now sells 60% value added products (value added defined as product with EBITDA/ ton of Rs 4000 or higher) & 40% commodity products which is reverse of what existed 5 years ago. Company sells majority (80-90%) of sales through distributor network which shows how critical company is positioned as transportation cost can be higher if the distance is higher between place of production & selling.

Recent merger announcement with listed subsidiary – Apollo Tricoat –

Apollo tricoat – manufactures products with EBITDA double the company's margins (of Rs 8000/ton) as products manufactured have less competition & uses majority of distributors (60%) are same. The company is being run by Mr. Rahul Gupta who is son of APL Apollo Tube promoter Mr. Sanjay Gupta. The company was initially acquired by promoter group, but was sold to APL apollo at higher price within a period of 1 year. Now, the Tricoat's products are being accepted by the market & capacity utilization is on the rise.

The rationale for merger is – both are engaged in ERW segment, have similar products distributors & use same brand. The factories are located in close proximity. The factory machinery would be merged & the empty factory would be converted into warehouse for distribution. The well integrated production line would reduce costs. Currently, Tricoat products were present only in North & South, with merger tricoat company products can be sold pan India & APL apollo's margins get a boost.

FINANCIALS –

Income Statement (in Rs Millions)	3/31/16	3/31/17	3/31/18	3/31/19	3/31/20	3/31/21
Total Revenues	**42136**	**39280**	**53404**	**71610**	**77365**	**85357**
Cost of Goods Sold	-35583	-32375	-45522	-63136	-65863	-71648
Gross Profit	**6553.3**	**6905.1**	**7881.6**	**8474.3**	**11502**	**13709**
% Gross Margins	***15.60%***	***17.60%***	***14.80%***	***11.80%***	***14.90%***	***16.10%***
Operating Income	**2535.8**	**2871.1**	**3301**	**3330.8**	**3972.5**	**6118.8**
% Operating Margins	***6.00%***	***7.30%***	***6.20%***	***4.70%***	***5.10%***	***7.20%***
Net Income	**1005.6**	**1521.1**	**1581.3**	**1482.5**	**2379.7**	**3601.6**
Effective Tax Rate %	38.30%	29.60%	35.30%	34.70%	13.60%	25.30%

KEY RATIOS –

Ratios	3/31/16	3/31/17	3/31/18	3/31/19	3/31/20	3/31/21
Return on Capital %	19.40%	20.80%	19.30%	17.10%	16.60%	24.70%

Return on Common Equity %	18.90%	23.90%	20.50%	16.50%	20.50%	23.60%
Gross Profit Margin %	15.60%	17.60%	14.80%	11.80%	14.90%	16.10%
SG&A Margin %	1.90%	2.20%	1.90%	1.80%	2.50%	1.50%
EBITDA Margin %	6.80%	8.60%	7.20%	5.50%	6.30%	8.40%
Net Income Margin %	2.40%	3.90%	3.00%	2.10%	3.10%	4.20%
Fixed Assets Turnover	6.8	5.6	6.5	7.4	5.9	5.2
Current Ratio	1.1	1	1	1	1.2	1.2
Quick Ratio	0.3	0.3	0.4	0.4	0.5	0.4
Avg. Cash Conversion Cycle	42.3	46	37.3	34.4	27.1	13.2
Avg. Days Sales Outstanding	17.2	24	24.9	24.9	24.2	13.5
Avg. Days Outstanding Inventory	47	60	42.5	39.7	43.6	39.3
Avg. Days Payable Outstanding	21.9	37.9	30.1	30.2	40.7	39.6
Total Debt / Equity	114.60%	84.50%	92.50%	89.00%	57.50%	29.10%
Total Debt / Capital	49.90%	43.10%	45.30%	44.20%	35.00%	21.50%
Total Liabilities / Total Assets	65.80%	61.90%	61.60%	65.20%	55.60%	46.10%
EBITDA / Interest Expense	4.6	5	5.1	3.6	4.9	10.8
Net Debt / EBITDA	2.3	1.8	2	2	1.6	0.2

The company has been prudent in taking debt as excess debt in this sector has lead companies into bankruptcy in the past. The company has reduced debtor days, & enjoys credit period from suppliers such as JSW steel, Tata Steel as it one of the largest HR coil purchaser in India. The ratios look decent as company has been able to generate 5-6X asset turnover, which is lower than 9-10X which can be done at peak capacity but has fared better than competitors on asset turn.

COMPETITORS –

1. Surya Roshni – the company has been present in pipe & tube segment for past 4 decades & enjoys high market share in Galvanized pipe segment which APL apollo has low market share. Company competes with APL in commodity segments & has forayed recently in value added segment with DFT technology. Surya also has presence in Electric & LED segment which diversifies revenue but also reduces focus on products. The company's EBITDA/ton is lower than that of APL apollo.

MANAGEMENT –

1. Mr. Sanjay Gupta - Chairman & Managing Director - Sanjay has more than 30 years of experience in diverse steel industry segments. Under his leadership, the company has evolved and developed from a steel tube manufacturer into a global leader of branded structural steel tubing products.
2. Mr. Arun Agarwal - Chief Operating Officer - A Chartered Accountant, Arun has 20 years of professional experience in the Steel Industry and has been associated with the Company since 2009. He has been actively involved in all strategic decision making within the group and has over the years grown with APL Apollo.

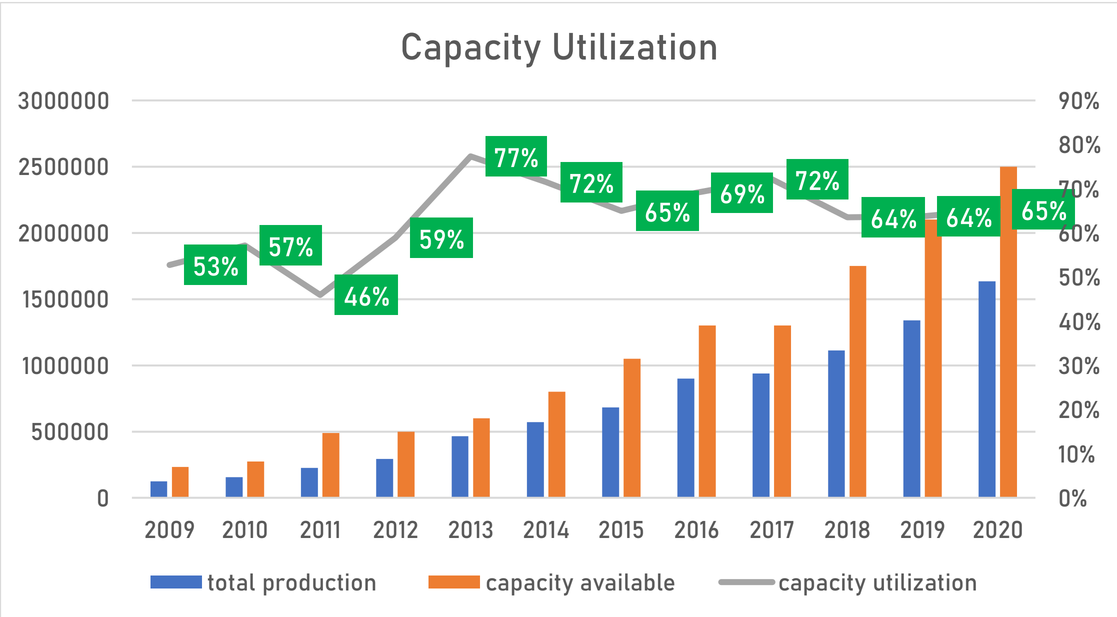
3. Mr. Rahul Gupta - MD Apollo Tricoat - Rahul has an experience of 5 years in Structural Steel Tubing business and has handled Operational Management, Marketing, and Institutional Sales. He is the recipient of the 'Young Achiever Award' for Organisation Building at Global HR Summit 2017. Rahul has completed B.Com (Hons) from Delhi University. He has also completed executive courses in the field of Management from reputed B-Schools like the London School of Economics, Indian Institute of Management, Ahmedabad.

STRENGHTS –

1. Leader in innovating products & branded commodity products.
2. Pan India distribution network & factories located.
3. New technology DFT has given head start & improved margins.
4. Company passes on raw material price changes to customers.
5. Company has large SKU which helps meet all sizes demand from one brand only.

WEAKNESS –

1. The traditional business has low EBITDA margins.
2. Competitors venturing into value added products leading to increased competition.
3. Company's capacity utilization has remained low but still company has expanded facilities & targeting increased capacity of 3 MTPA by FY 22 & adding in value added products majorly.



OPPORTUNITIES –

1. Converting wooden, plastic, etc products into steel (ex – wooden steel frames converted into steel, company sells under brand Chaukhat).
2. India currently uses only 5-7% of steel in pipes versus 10% of steel.
3. More usage of pipes in structural industry.

THREATS –

1. Unorganized player in local regions can supply at lower prices.
2. The PVC pipes had disrupted this market somewhat & reduced market size of ERW pipes.

CONCLUSION –

Overall, the company's management has been able to deliver what it has promised & recent reduction in debtor days was a favourable announcement which has lead to reduced debt & leaner & stronger company. It is targeting to be debt free. But the overall asset turn company is targeting is at 4-5X similar to current levels when it can be increased further. Also, promoters selling Apollo Tricoat company at a profit raises some questions, except for that the management looks clean. The focus of the company is to build market & market share in value added products which can be seen in the results of the company.

Everything at last comes to valuations. The company's valuation (Market cap - Rs 17,000 cr) seems to be pricing in management's bullish commentary, & not considering inventory losses which it has incurred due to fall in steel prices in the past. One could keep the company in watchlist & add it on dips as the fundamentals for the stock seem to be in place.

Things to monitor –

1. EBITDA/ ton of company (if rises above 6000/ton then +ve)
2. Value added product share in revenue mix
3. Capacity utilization (above 80% or 7-8X asset turn +ve)
4. Competitor (Surya Roshni) expansion into DFT
5. How next generation (Rahul Gupta) will transition into the board?
6. Inventory gain/ losses rising from change in Hot Rolled Coil steel prices (As company carries 100,000 – 150,000 of monthly inventory)

RISK REWARD –

	BEAR	BASE	BULL
TOTAL CAPACITY	40,00,000	40,00,000	40,00,000
CAPACITY UTILIZATION	55%	70%	80%
TOTAL PRODUCTION	2200000	2800000	3200000
EBITDA/TON	4000	5000	6000
EBITDA (IN CR)	880	1,400	1,920
EV/ EBITDA (HISTORICAL)(IN TIMES)	10	15	25
IMPLIED EV (IN CR)	8,800	21,000	48,000
DEBT	0	0	0
MARKET CAP (IN CR)	8,800	21,000	48,000
CURRENT MARKET CAP	17098		
UPSIDE/ (DOWNSIDE)	-49%	23%	181%