APL Apollo Tubes

Poised to steel the march in a new avatar

CMP	Target Price
Rs 1,852 as of (November 3, 2017)	Rs 2,812 12 months
Rating	**Upside**
BUY	51.8 %

Rapidly scaling revenue; Initiate at BUY

- Initiate BUY on this midcap and under-researched name, TP Rs2,812. APAT, a specialized steel processor, would double its profits and improve its ROCE to 30.5% from 20.6% by FY20. The stock is undervalued at PER of 13x FY20E.
- APAT is No. 1 steel pipe maker with 13% domestic market share. We are confident that this would rise to 17% by FY20. APAT has managed to grow revenues faster than the sector (5Y CAGR of 27% vs the sector's 9%) due to its core strategy which is focused on innovation, branding/distribution and capacity expansion. Its earnings expanded at 24% CAGR during the same period. APAT is now increasing its capacity by 54% this year.
- APAT's earnings are insulated to steel's cyclical nature. Most of APAT's 400 products are specialized and are used in high-growth sectors. The stock should not be looked as a steel sector play but a bet on India's construction/infrastructure/agriculture push. Our TP offers 52% potential upside and is based on PER of 20x FY20E.

Shift to high-margin specialized products

Mr. Sanjay Gupta, a first-generation entrepreneur, is promoter of APAT. The company moved up the value chain from low-end steel products to value-added niche products during the past four years. APAT's EBITDA margins improved to 7.3% from 5.8% in FY15-18. APAT was the first company in India to offer pre-galvanised and colour-coated pipes, and has introduced the latest technology, Direct Forming Technology (DFT), which has enabled it to offer customized products at a lower cost and in less time than its competitors.

Focus on high-growth sectors, expansion of returns

APAT has a presence in sectors that are growing at a higher pace than the general economy. They include residential and non-residential construction, manufacturing (consumer goods and automobiles), infrastructure, renewable energy and agriculture. We forecast revenues to clock 17% CAGR FY17-20 backed by strong demand for APAT's products. This will drive EPS to more than double in a span of three years. ROE/ROCE will improve to 27.1/30.5% in FY20 from 22.7/20.6% in FY17.

Outperformance is Sustainable; Initiate at BUY

APAT's valuation is attractive despite the share price run-up in the past one year. Stock trades at a PER of 13x FY20E, even though we forecast EPS will increase by 19%/36%/40% in FY18/19/20. This could be because of having less coverage and liquidity. We initiate on the stock with BUY recommendation and Rs2,812 TP.

Financial Snapshot (Consolidated)

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	42,136	45,450	52,730	61,913	73,430
EBITDA	2,817	3,244	3,863	4,763	5,980
EBITDA Margin (%)	6.7	7.1	7.3	7.7	8.1
APAT	1,259	1,459	1,735	2,366	3,317
EPS (Rs)	53.7	61.8	73.5	100.3	140.6
EPS (% chg)	97.4	15.1	18.9	36.4	40.2
ROE (%)	23.7	22.7	21.9	24.4	27.1
P/E (x)	34.5	29.9	25.2	18.5	13.2
EV/EBITDA (x)	17.7	15.2	12.7	10.0	7.6
P/BV (x)	7.6	6.1	5.0	4.1	3.2

Source: Company, Emkay Research

Change in Estimates	
EPS Chg FY18E/FY19E (%)	NA
Target Price change (%)	NA
Target Period (Months)	12
Previous Reco	NOT RATED

Emkay vs Consensus

EPS Estimates	FY18E	FY19E
Emkay	73.5	100.3
Consensus	80.7	104.6
Mean Consensus TP (12M)		Rs 1,907

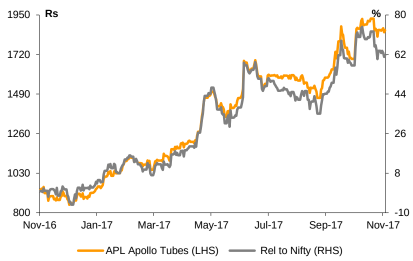
Stock Details	
Bloomberg Code	APAT IN
Face Value (Rs)	10
Shares outstanding (mn)	24
52 Week H/L	1,968 / 821
M Cap (Rs bn/USD bn)	44 / 0.68
Daily Avg Volume (nos.)	14,828
Daily Avg Turnover (US$ mn)	0.4

Shareholding Pattern Sep '17	
Promoters	37.5%
FIIs	-%
DIIs	14.5%
Public and Others	48.1%

Price Performance

(%)	1M	3M	6M	12M
Absolute	9	17	25	107
Rel. to Nifty	2	13	11	69

Relative price chart



Source: Bloomberg

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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1.0 Investment Thesis: No. 1 steel pipe maker to sustain outperformance

Exhibit 1: Investment thesis

Investment Rationale	Core Competence
Demand for ERW pipes growing at 10% pa	Product portfolio is 3x bigger than nearest competitor
Market share expansion to 17% from 13% in 3 years	No of distributors is 4x higher than nearest competitor
Margin expansion to 8.1% from 7.1% in 3 years	First mover advantage in introduction of new technologies (DFT, customization)
Strong EPS CAGR of 31% for 3 years	Building entry barriers through branding
ROE expansion to 27.1% from 22.7% in 3 years	
Compelling BUY in midcap space	

Financial metrics	Our recommendation
Sales Volume CAGR of 26% in last 10 years	Attractively priced at 13x PER FY20E
Expected revenue CAGR of 17% in 3 years	Our TP based on 20x PER offers 52% potential upside
Strong B/S and cash flow that allow company to create future growth	
FCF generation to accelerate post completion of capex	

Source: Emkay Research

1.1 Indian steel pipe industry is in top gear

Industry growing at 10% pa

India is leading ERW steel pipes and tubes manufacturing hub globally with 7m ton capacity. The domestic market size for ERW steel pipes is Rs300bn and is expected to grow 10% annually for the next 5 years. Demand is driven by: 1) rise in residential construction and 2) infrastructure development (conduits, support structures, fencing, railings and scaffolding in ports, stations, airports). APAT's volume growth should be higher since it continues to gain market share from organized as well as from unorganized competitors.

1.2 Strong revenue growth led by capacity expansion

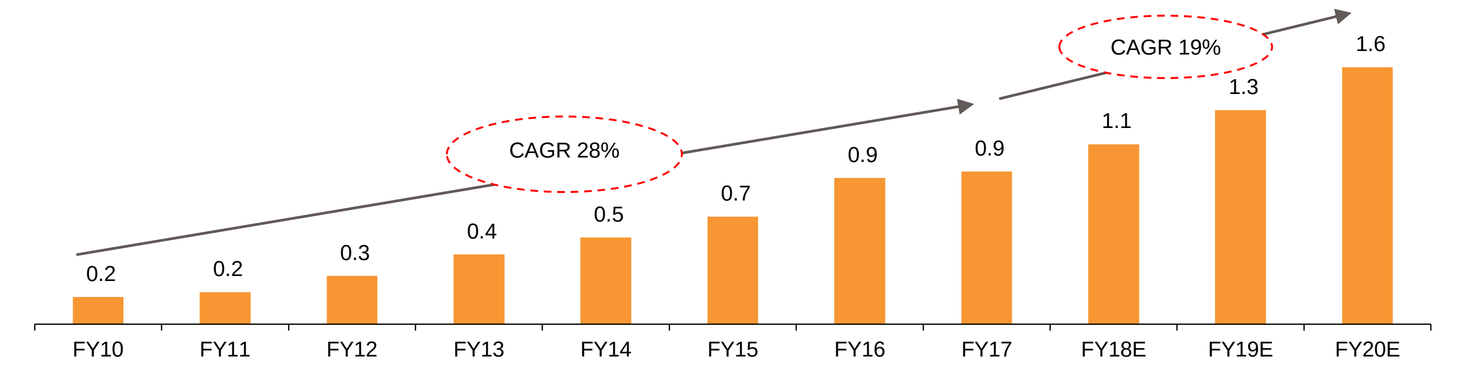
13% market share in ERW segment

APAT is the largest manufacturer of Electric Resistance Welded (ERW) steel tubes in India, supported by strong 26% CAGR in manufacturing capacity over FY12-17. A large capacity combined with investments in distribution and branding has driven 26% sales volume CAGR in the same period.

Large capacity expansion in progress

The company is now increasing its capacity by 54% to 2m ton by end-FY18. This will include addition of DFT-based capacity, which would enable superior products and smaller delivery timelines. We expect sales volume/revenue CAGR of 19%/17% in FY17-20E. APAT's key focus areas are: 1) Market Expansion of DFT, 2) Exports (currently contribute 6%, targeting 15% in 3 years) and 3) OEMs (currently contribute 2%, targeting 10% in 3 years).

Exhibit 2: APAT's sales volume (m ton) & growth (%)



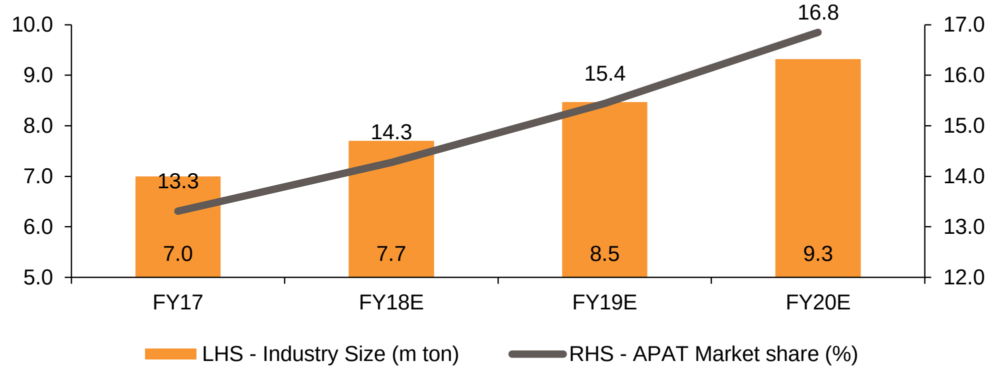
Source: Company, Emkay Research

1.3 Market share gains to 17% from current 13%

Market share gains backed by capex

APAT's market share would rise to 17% by FY20 from current 13%. It has managed to grow revenues faster than the sector (5Y CAGR of 27% vs the sector's 9%) due to its core strategy which is focused on innovation, branding & distribution and capacity expansion.

Exhibit 3: APAT's market share (%)



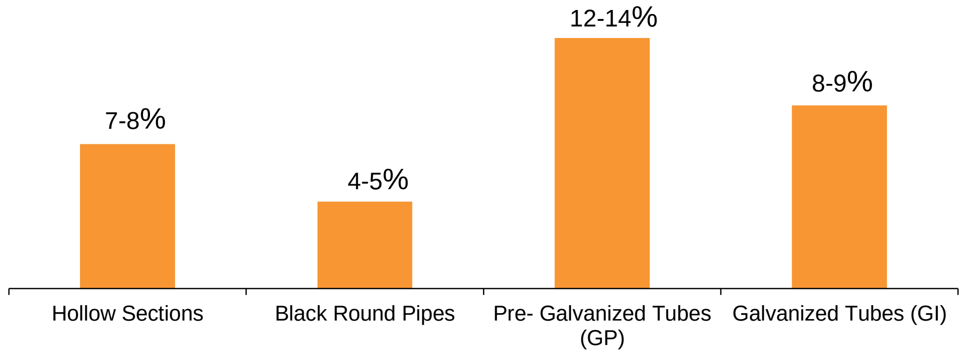
Source: Company, Emkay Research

1.4 Margin expansion led by value added products

Focus on value added and customized products

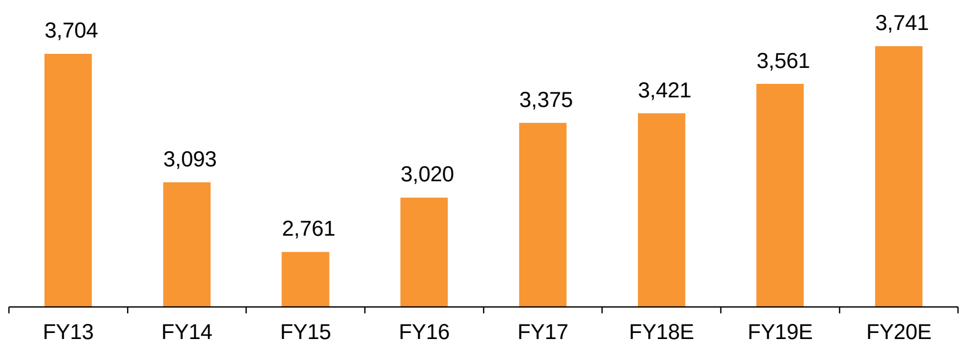
We expect APAT's EBITDA spread to rise to Rs3,741/ton by FY20 from Rs3,375/ton in FY17. This will be on the back of increase in sales of higher margin products like pre-galvanized tubes, door & window frames. Also, the DFT products have better margins as they offer significant saving in costs for the same strength and quality.

Exhibit 4: APAT's product margin profile (%)



Source: Company, Emkay Research

Exhibit 5: APAT's avg EBITDA/ton (Rs)



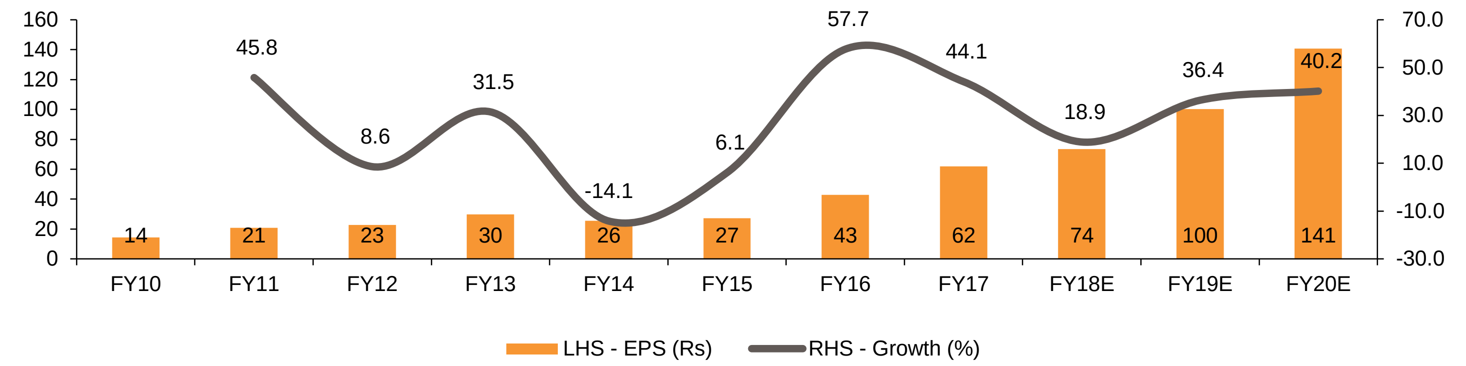
Source: Company, Emkay Research

1.5 Strong EPS CAGR of 31% FY17-20E

Earnings growth backed by revenue growth and margin expansion

Demand for APAT's key products is strong. We forecast revenue CAGR of 17% FY17-20 backed by strong demand for APAT's products. EBITDA margins will continue to improve on better operational efficiency and increasing contribution from high-margin products. This will drive 31% EPS CAGR during FY17-20E.

Exhibit 6: EPS (Rs) & growth (%)



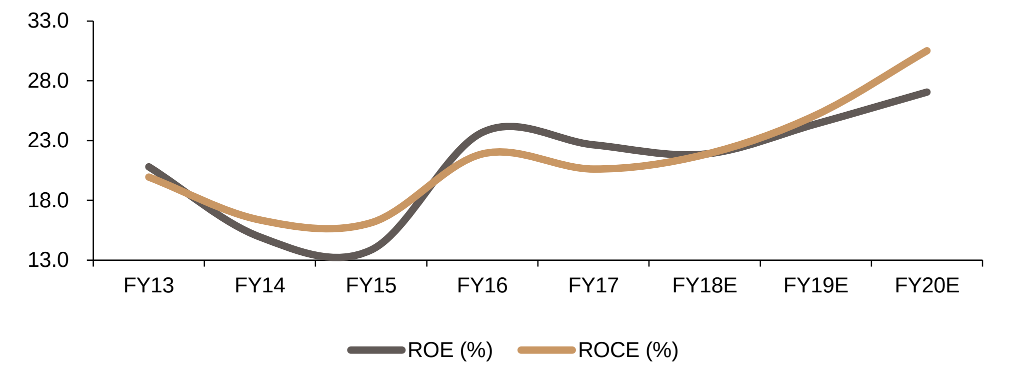
Source: Company, Emkay Research

1.6. Improving return profile

Significant improvement in ROE/ROCE

APAT already earned ROE/ROCE of 22.7%/20.6% in FY17. This will improve further on rising contribution of more profitable products and earnings boost. We forecast ROE/ROCE of 27.1%/30.5% in FY20E.

Exhibit 7: ROE/ROCE (%)



Source: Company, Emkay Research

1.7. Compelling BUY in the midcap space

52% potential upside from current levels

APAT stock outperformed BSE Midcap index by 45% in the last one year. We expect this outperformance to sustain on robust earnings performance and return profile expansion. We believe the stock is still undervalued as it's current PER of 13x FY20E does not factor in the EPS CAGR of 31% FY17-20E.

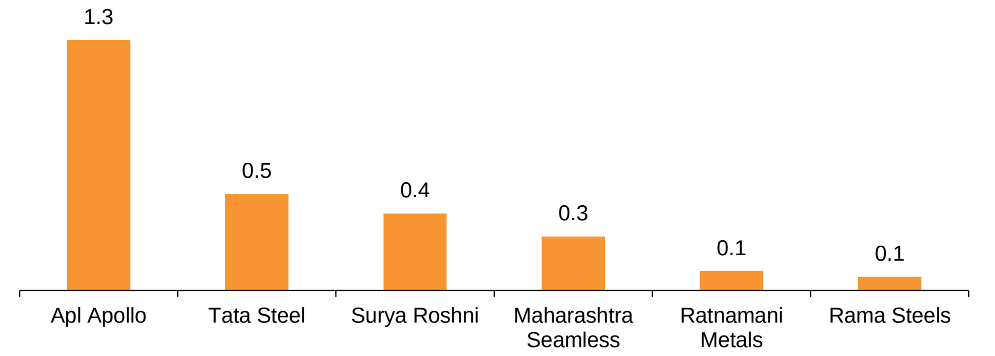
2.0 Fragmented steel pipe market offers share gain opportunities for scale players

2.1 A 40% of Rs300bn industry is unorganized

No. 1 player in ERW pipe market

Steel pipes were traditionally used for the transportation of water, liquid, oil and gases. However, they have now been adopted as hollow support structures in sectors such as property, construction and telecoms. As per the management, India's steel tube and pipe industry is among the fastest growing in the world and production is around 7m ton. The domestic market size for ERW steel pipes is Rs300bn and is expected to grow 10% annually for the next 5 years. A large portion of current demand is met by unorganized companies, but market share is steadily shifting to the organized sector. Leading steel pipe companies include Surya Roshni, Welspun, Tata and Jindal industries.

Exhibit 8: Peer pipe capacity (m ton)



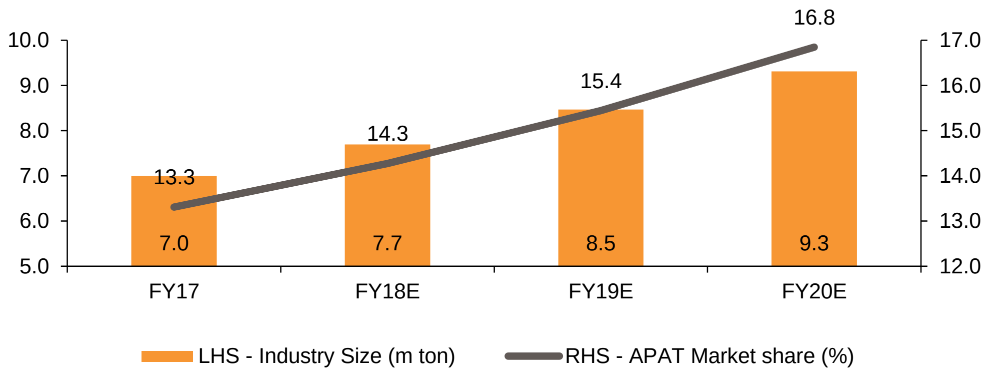
Source: Company, Emkay Research

2.2 Market share to expand to 17% by FY20E from current 13%

APAT has grown much faster than peers

APAT's capacity expansion has come about during the period when capacity of the overall organized industry has grown at a much slower pace. Thus, APAT has benefited from market share gains from organized as well as unorganized competitors. We expect APAT's market share to rise to 17% in FY20E from current 13% backed by capacity expansion and aggressive sales strategy.

Exhibit 9: APAT's market share (%)



Source: Company, Emkay Research

2.3 Industry growth drivers – Expect 10% CAGR for next 5 years

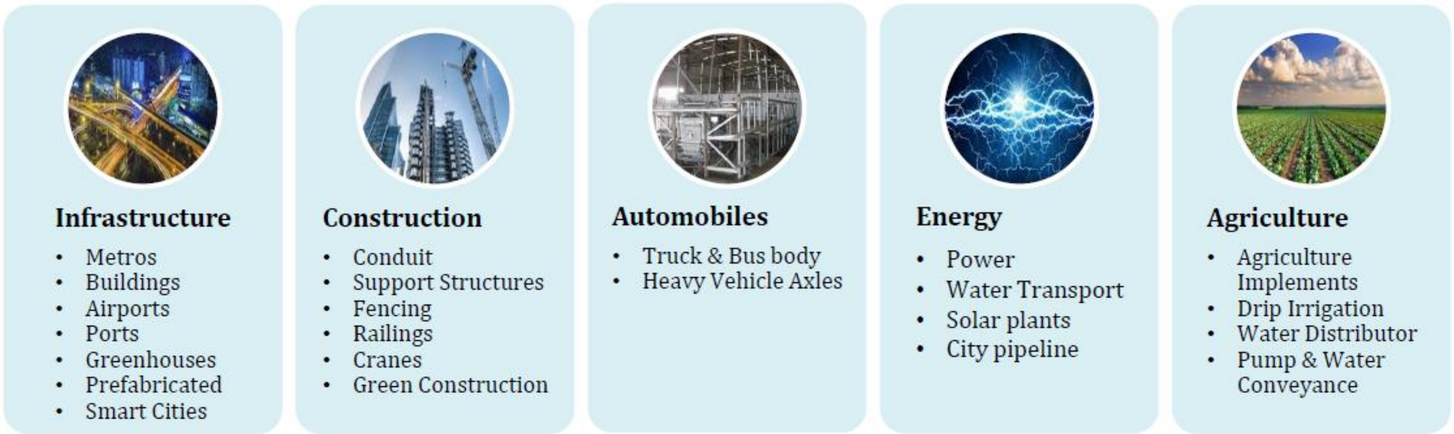
Strong demand trends visible

The demand for steel pipes will come primarily from three sectors: 1) construction and infrastructure: this is driven by government spending on modern infrastructure like ports, stations and airports, where steel pipe is used in a variety of applications such as conduits, support structures, fencing, railings and scaffolding; 2) urbanization: from government initiatives like smart cities and housing for all by 2022; and 3) agriculture: where applications for steel pipes and tubes include sprinkling, drill rods, water distributors, submersible pumps and conveying water.

Multiple application in high growth sectors

Segments that are growing in the ERW pipes' space are the pre-galvanized pipes (GP) primarily consumed in the coastal and hilly areas (Kerala, Goa, Andhra, Himachal, Uttarakhand) which are used as a replacement for wood in the applications of roofing structures providing shelter from rains and sunlight.

Exhibit 10: Industry application



Source: Company

New industry applications

Additional applications for the product are fencing, gates and grills. Hollow sections are also witnessing strong growth in the application areas of infrastructure (metros /airports), construction (pre-fab buildings) and newer applications like agricultural implements, construction equipment, gym/sports equipment, solar tracking systems and automobile applications like truck & bus body/ heavy vehicle axles.

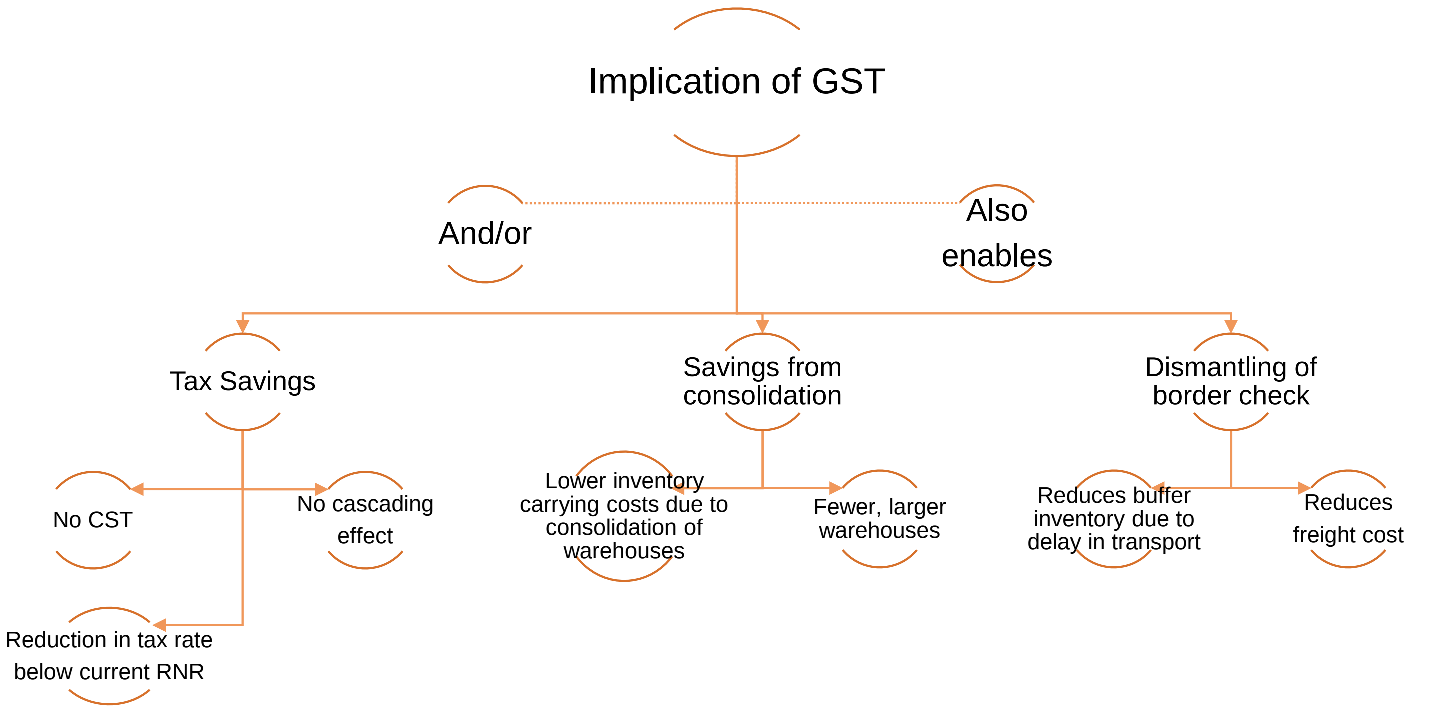
APAT moving away from low growth segment

Segments that are witnessing a decline are galvanized (GI) pipes that are primarily used in traditional applications like irrigation, agriculture, firefighting and plumbing which have been replaced by PVC pipes. Black Round Pipes which are a low margin product are also gradually being replaced by structural pipes.

GST to help eat up unorganized market share

The implementation of GST is likely to benefit the company in terms of better market share (current share ~13%) in the coming years as organized players will benefit the most and are growing at a faster pace than the industry.

Exhibit 11: GST to be a game changer



Source: CRISIL Report

3.0 APAT's core competence – Ahead of competition

No.1 player

APAT is India's leading manufacturer of ERW steel pipes, with a current capacity of 1.3m ton and is in process of expanding capacity to 2m ton by FY18. The company has managed to grow revenues faster than the sector (5Y CAGR of 27% vs the sector's 9%) due to its core strategy which is focused on innovation, branding & distribution and capacity expansion.

3.1 Product portfolio is 3x bigger than nearest competitor

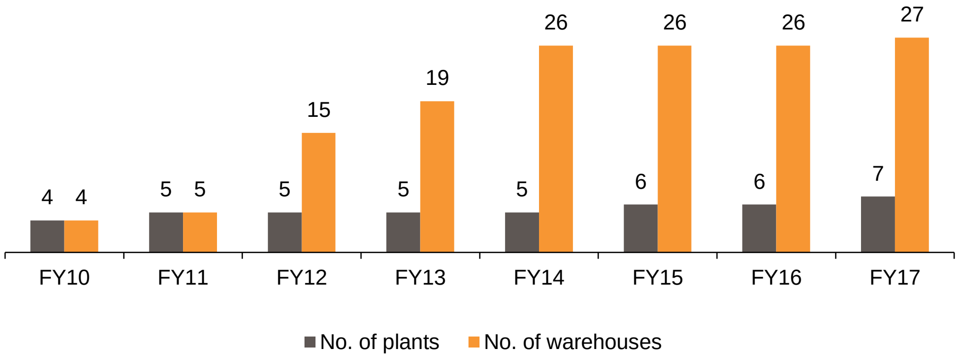
Vast product portfolio

APAT has developed a portfolio of 400 products, which is more than three times the offerings of its nearest competitor. APAT'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.

Exhibit 12: APAT's product portfolio

Source: Company

Exhibit 13: APAT's No. of plants and warehouses



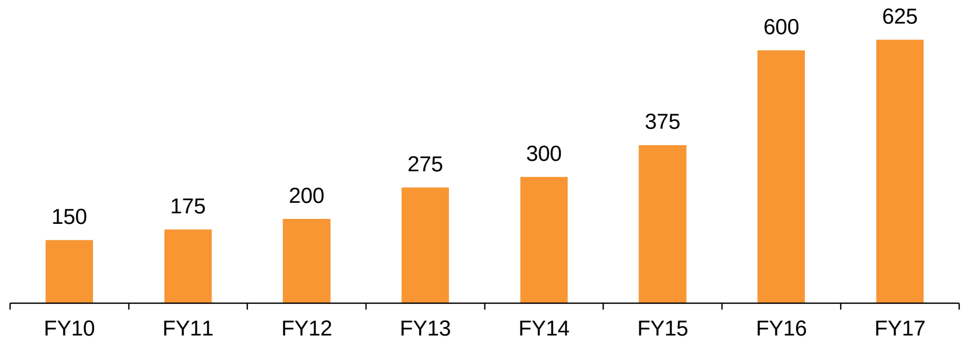
Source: Company

3.2 No. of Distributors is 4x higher than nearest competitor

Strong distribution network

APAT has wide coverage through 625 distributors and 40,000 retailers in 300 cities/towns. This is more than four times than that of the nearest competitor. The company 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. 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.

Exhibit 14: No. of Distributors



Source: Company

3.3 First Mover Advantage in introduction of new technologies

Focus on innovation

APAT was the first company in India to offer pre-galvanised and colour-coated pipes, and has introduced the latest technology, Direct Forming Technology (DFT), which has enabled it to offer customized products at a lower cost and in less time than its competitors.

APAT is the first company to bring DFT in India. It is used in manufacturing hollow sections. The capex cost is 15-20% higher than normal capacity but has multiple benefits:

- **3-10% Savings on RM.** DFT eliminates the wastage which earlier used to gather at the edges when round pipes were converted into square or rectangular pipes.
- **Customized/Small orders to drive market share gains.** Introduction of DFT enables APAT to produce pipes in smaller batches (10-20 ton) against the traditional requirement of 400-550 ton before making any changes. This allows APAT to accept small orders in customized sizes and thus serve a larger part of the untapped market. APAT has already customized 300x300mm size for the first time in India and thereby the only producer. This has led the company to develop 12 new sizes that can be leveraged going forward.
- **Export opportunities.** DFT products are well accepted in export markets of Europe, Japan and USA. This will provide APAT a level playing field compared to global players. Management targets exports to grow at over 50% due to DFT, a key catalyst for topline growth over FY17-FY20E.
- **New opportunities.** APAT has entered into new products such as Truck & Bus Body, Agricultural Implements, Gym/Sports Equipment, Solar Tracking systems etc. There is a greater acceptance of the superior quality products in the market which is a result of the new technology.

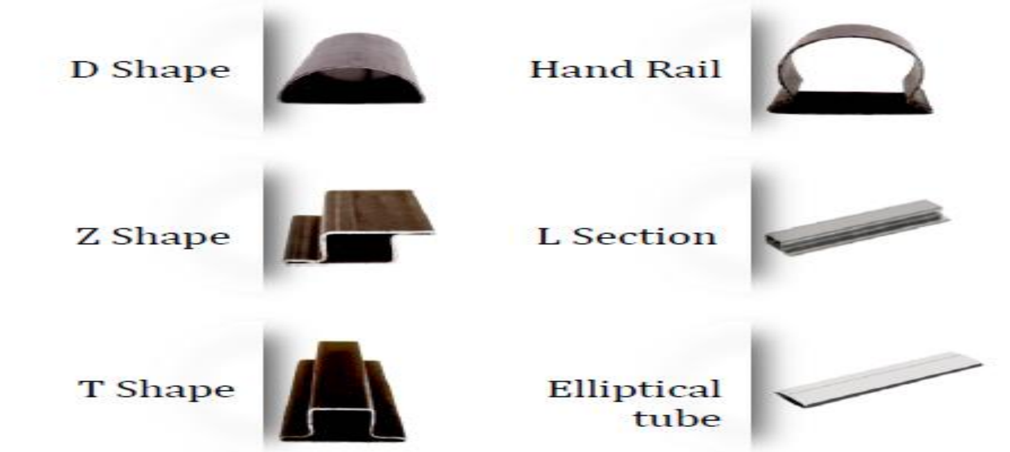
APAT has also got a few products patented like Door Frames, Window Frames, Hand Rail, T-Section, Colour Coated Pipes, Narrow & Small Sections (catering to affordable housing). Benefits of these are:

- Lowering cost of door frames by 1/3 compared to wooden frames
- Color coated pipes allows end-consumer to have better aesthetic value for the homes, lower cost with longer product life

Product for newer applications

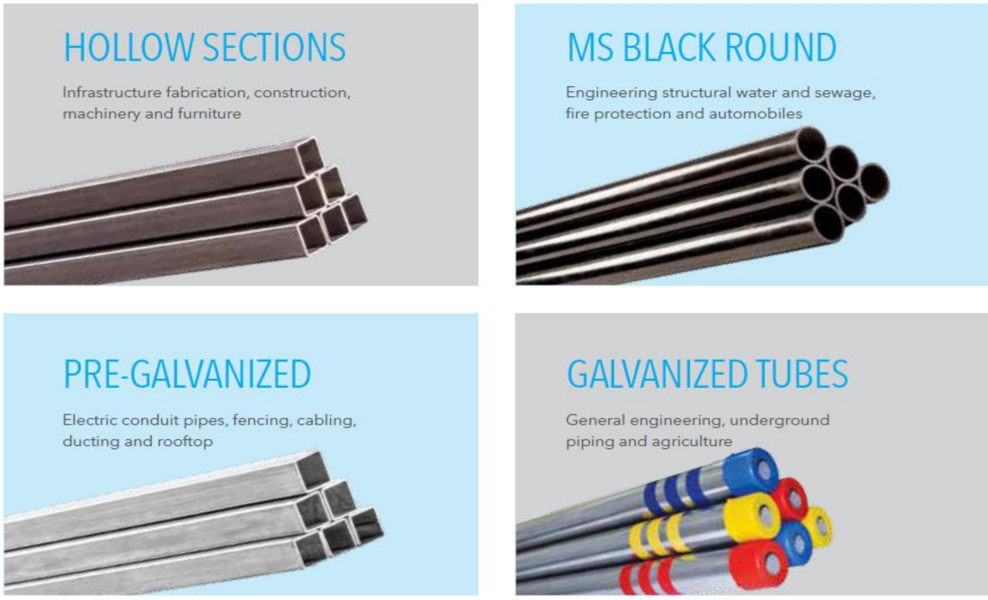
APAT has announced a strategic tie-up with NEXTracker to manufacture a key structural component of its solar tracking system in India. NEXTracker would get highest quality steel products sourced for its solar parks and power plants in India. This tie-up also allows APAT to penetrate rapidly into the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

Exhibit 15: APAT's innovative products



Source: Company

Exhibit 16: Products end-use



Source: Company

3.4 Building entry barriers through branding

Focus on brand creation

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.

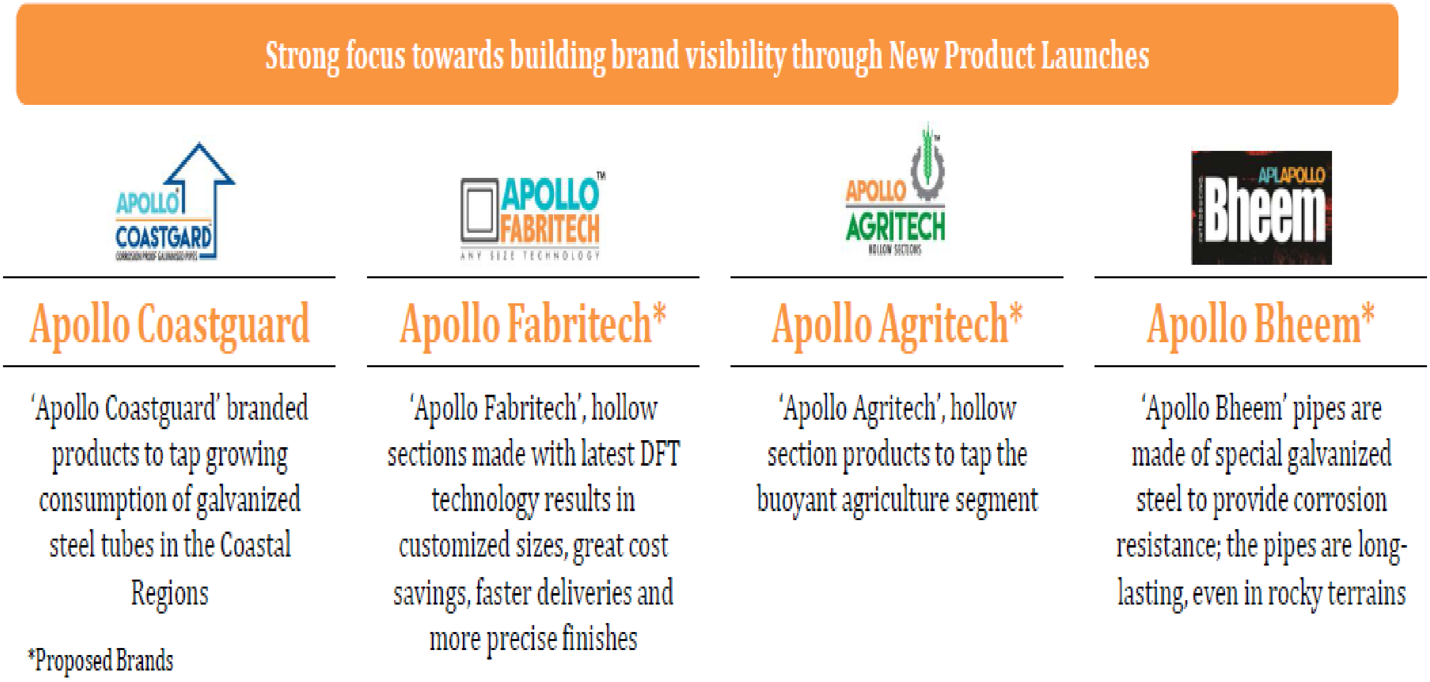
Benefits visible now

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. APAT has budgeted Rs250m (0.5% of FY17 revenue) for this branding exercise.

New products under new brand

APAT 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 and making them 100% rust proof.

Exhibit 17: APAT's push towards branding



Source: Company

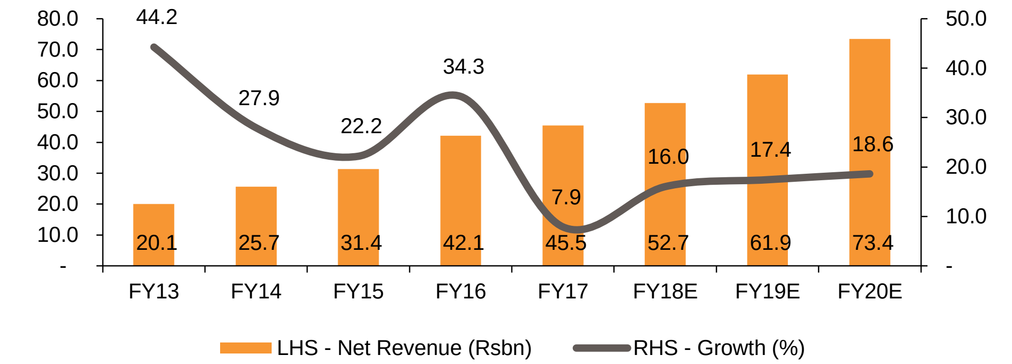
4.0 Financial Forecasts

4.1 Double Digit Growth in Volumes + Margins to Expand = 31% EPS CAGR FY17-20E

Revenue CAGR of 17% FY17-20E

Over FY17-20E, we expect APAT's consolidated revenue to rise 17% CAGR backed by volume growth. Segments that are growing in the ERW pipes' space are the pre-galvanized pipes (GP) primarily consumed in the coastal and hilly areas (Kerala, Goa, Andhra, Himachal, Uttarakhand) which are used as a replacement for wood in the applications of roofing structures providing shelter from rains and sunlight. Additional applications for the product are fencing, gates and grills.

Exhibit 18: Revenue & growth trend

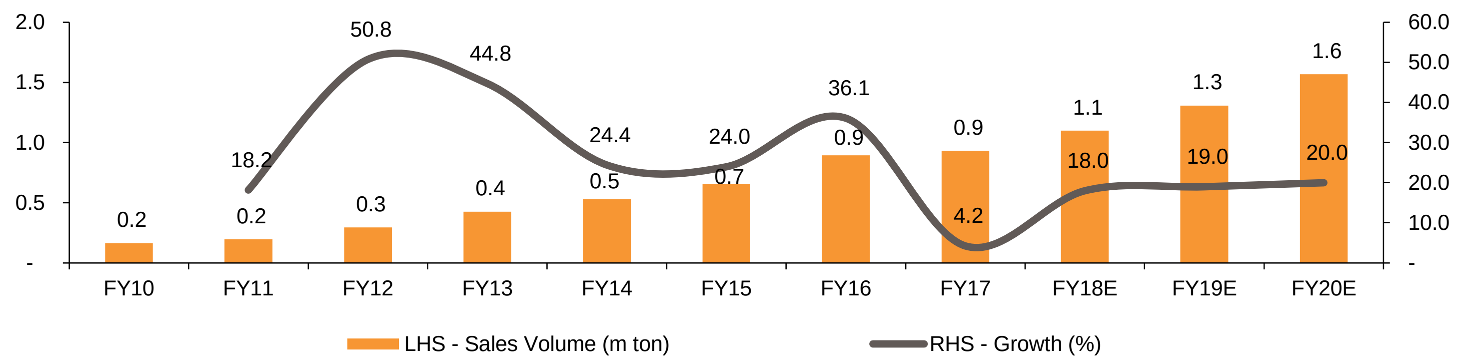


Source: Company, Emkay Research

Sales volume to rise 18% in FY18, 19% in FY19

APAT is India's largest player with a capacity of 1.3m ton which would be expanded to 2m ton by FY18 solely focused on the pipes and tubes business unlike some of the major competitors. Pipes capacity is more than double that of the nearest competitor. APAT enjoys economies of scale in raw material procurement and also has an advantage of lower freight costs with facilities and depots located close to demand hubs.

Exhibit 19: APAT's sales volume (m ton) & growth (%)

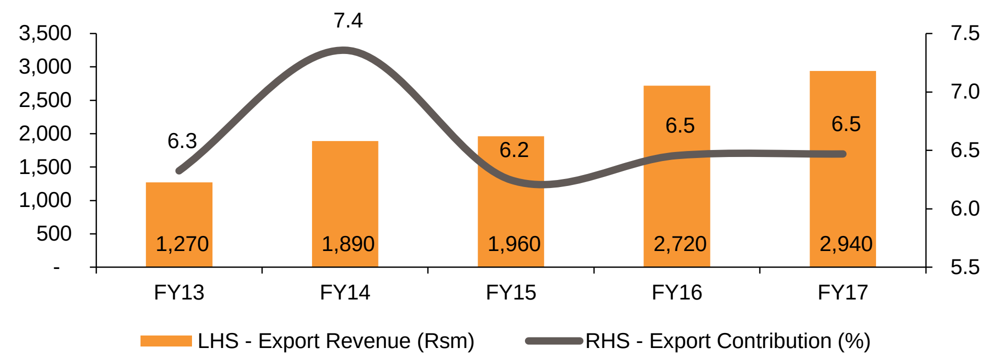


Source: Company, Emkay Research

Boost to export revenue

APAT is also focusing on export sales which would boost overall revenue. There is strong acceptance of APAT's value added products especially from DFT segment in the overseas market. We expect the contribution from export sales to rise to 15% by FY20 from current 6.5%.

Exhibit 20: Export revenue & its contribution to revenue



Source: Company, Emkay Research

Exhibit 21: Sales volume product wise ('000 ton)

	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Black Pipe	114.7	133.9	169.5	194.0	150.8	164.9	157.0	157.0
Square Pipe/Hollow Sections	157.2	191.2	247.8	425.5	474.9	470.5	396.3	271.6
GI Pipe	77.9	86.9	91.0	114.7	117.4	137.4	163.5	196.2
GP Pipe	75.7	117.6	148.2	159.5	188.5	222.0	264.2	317.1
DFT	-	-	-	-	-	104.4	261.6	392.4
Special Value Added products	-	-	-	-	-	-	65.4	235.5
Total Volume of main products	426	530	657	894	932	1,099	1,308	1,570
Growth (%)		24.4%	24.0%	36.1%	4.2%	18.0%	19.0%	20.0%

Source: Company, Emkay Research

Exhibit 22: Net Revenue Breakup (Rsbn)

	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Black Pipe	4.7	5.5	7.1	6.6	5.6	6.2	5.9	5.9
Square Pipe/Hollow Sections	6.5	8.0	10.5	14.7	18.2	18.0	15.2	10.4
GI Pipe	3.9	4.4	4.7	4.8	5.4	6.4	7.6	9.1
GP Pipe	3.8	6.0	7.6	6.7	8.8	10.4	12.3	14.8
DFT	-	-	-	-	-	4.1	10.3	15.4
Special Value Added products	-	-	-	-	-	-	2.6	9.3
Total Revenue of main products	18.9	23.9	29.9	32.8	38.0	45.0	53.8	64.8
Other Revenue (Scrap etc)	1.2	1.8	1.5	9.3	7.4	7.7	8.1	8.6
Total Revenue	20.1	25.7	31.4	42.1	45.5	52.7	61.9	73.4
Growth (%)		0.3	0.2	0.3	0.1	0.2	0.2	0.2

Source: Company, Emkay Research

Exhibit 23: Realization Breakup ('000 Rs/ton)

	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Black Pipe	40.7	41.1	42.0	33.8	37.5	37.5	37.5	37.5
Square Pipe/Hollow Sections	41.5	41.8	42.5	34.7	38.2	38.2	38.2	38.2
GI Pipe	49.6	50.6	51.4	42.2	46.3	46.3	46.3	46.3
GP Pipe	50.4	50.9	51.0	42.0	46.7	46.7	46.7	46.7
DFT	-	-	-	-	-	39.2	39.2	39.2
Special Value Added products	-	-	-	-	-	39.5	39.5	39.5
Average	44.3	45.1	45.5	36.7	40.8	40.9	41.1	41.3
Growth (%)		1.6%	1.0%	-19.3%	11.1%	0.2%	0.5%	0.5%

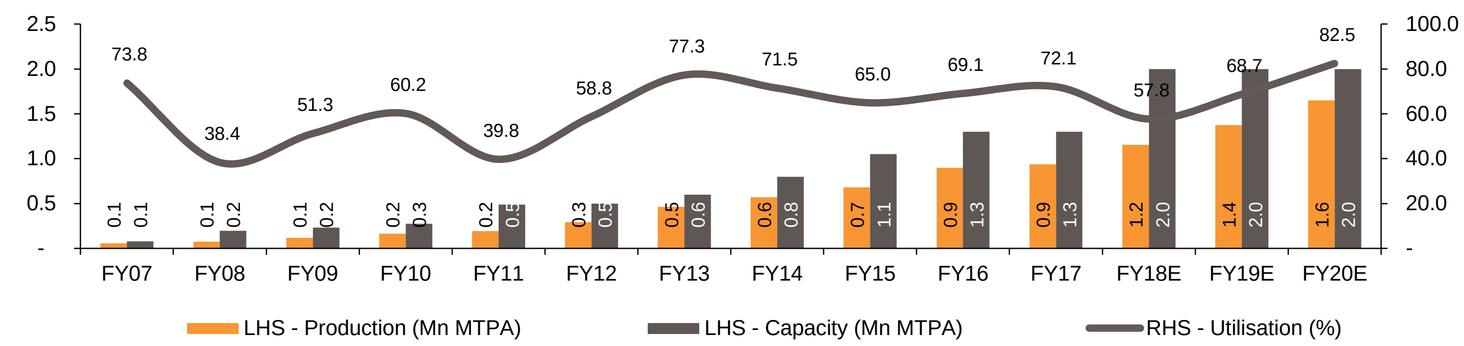
Source: Company, Emkay Research

Exhibit 24: EBITDA Breakup ('000 Rs/ton)

	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Black Pipe	2.0	1.6	1.4	1.7	1.8	1.8	1.8	1.8
Square Pipe/Hollow Sections	2.8	2.3	2.1	2.4	2.6	2.6	2.6	2.6
GI Pipe	5.6	4.4	3.9	4.6	4.9	4.9	4.9	4.9
GP Pipe	6.3	5.1	4.7	5.3	5.7	5.7	5.7	5.7
DFT	-	-	-	-	-	3.0	3.0	3.0
Special Value Added products	-	-	-	-	-	4.0	4.0	4.0
Average	3.7	3.1	2.8	3.0	3.4	3.4	3.6	3.7
Growth (%)		-16.5%	-10.7%	9.4%	11.8%	1.4%	4.1%	5.0%

Source: Company, Emkay Research

Exhibit 25: APAT's production and capacity (m ton) & utilization (%)



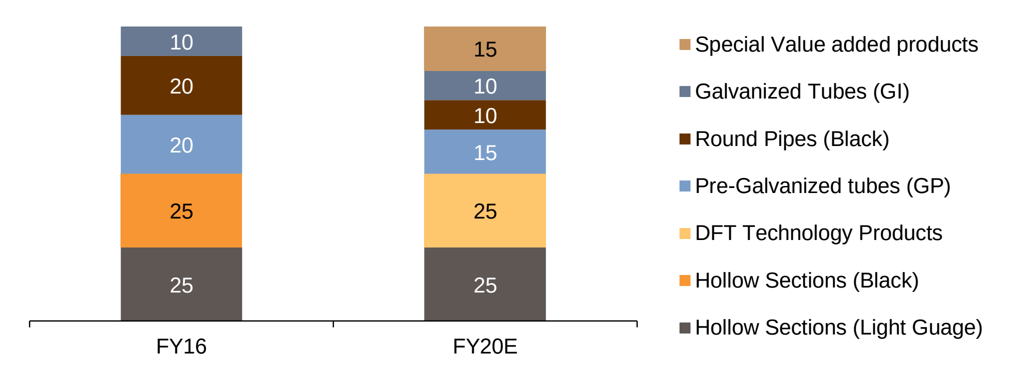
Source: Company, Emkay Research

APAT's main focus is on value added products

Contribution from value added products to rise to 90% in FY20

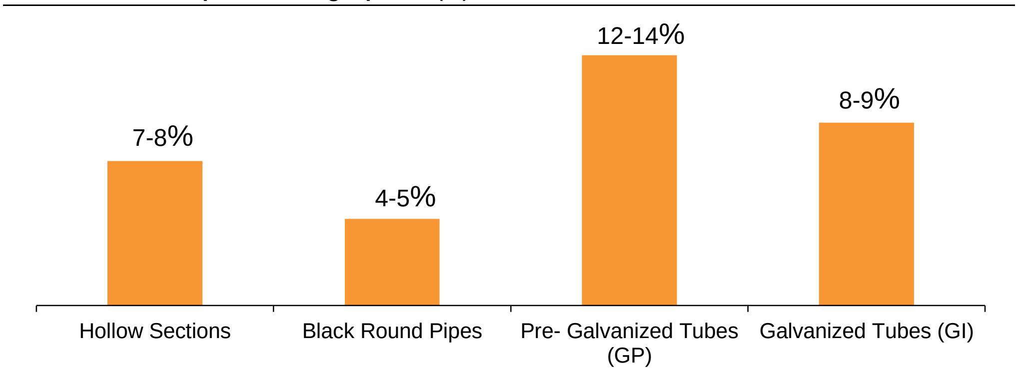
APAT's strategy has been to increase the value added products to its portfolio which have more than 8% EBITDA margin. With the introduction of DFT, we expect 90% of APAT's portfolio to be high margin.

Exhibit 26: Sales volume mix FY20E vs FY16 (%)



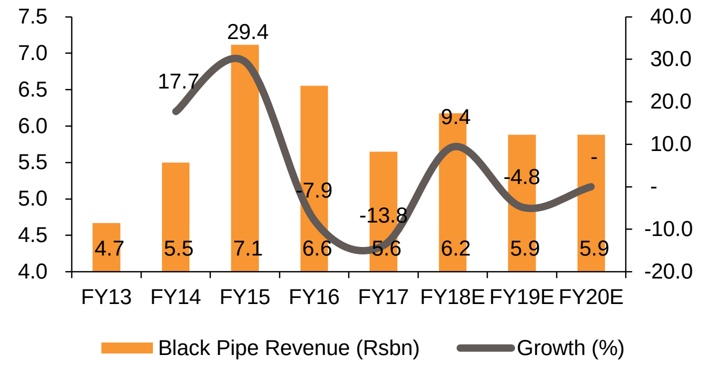
Source: Company, Emkay Research

Exhibit 27: APAT's product margin profile (%)



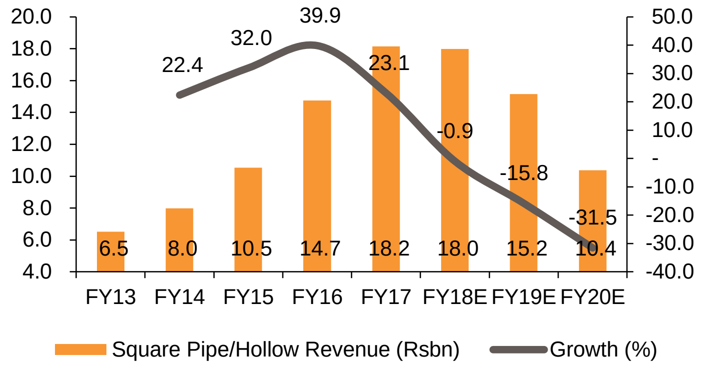
Source: Company, Emkay Research

Exhibit 28: Black pipe revenue & growth trend



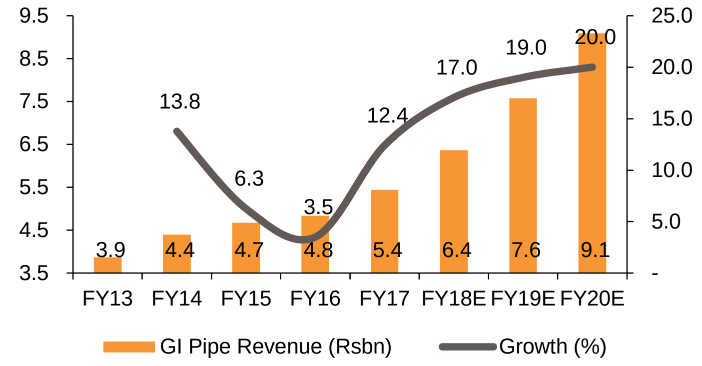
Source: Company, Emkay Research

Exhibit 29: Square pipe/hollow revenue & growth trend



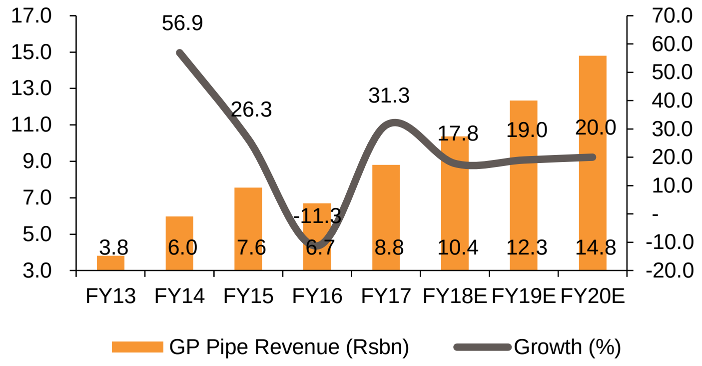
Source: Company, Emkay Research

Exhibit 30: GI pipe revenue & growth trend



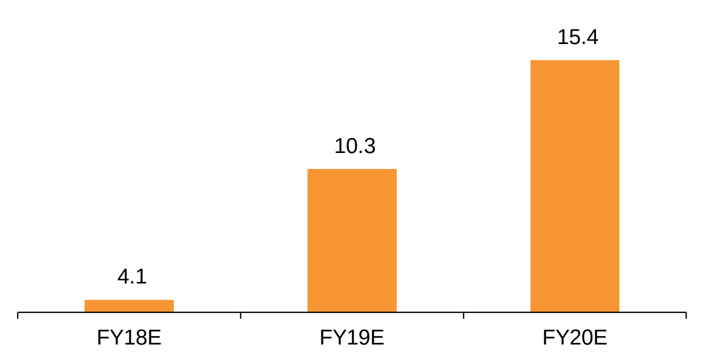
Source: Company, Emkay Research

Exhibit 31: GP pipe revenue & growth trend



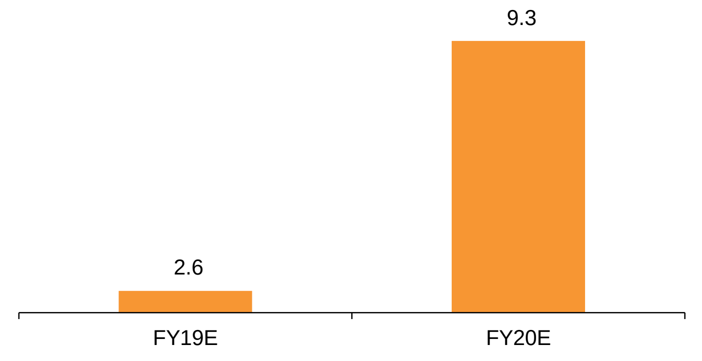
Source: Company, Emkay Research

Exhibit 32: DFT revenue (Rsbn)



Source: Company, Emkay Research

Exhibit 33: Special Value Added products revenue (Rsbn)



Source: Company, Emkay Research

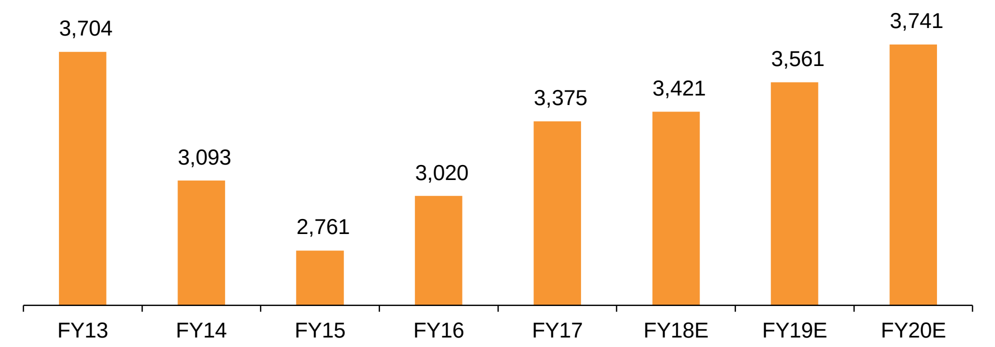
4.2 Significant EBITDA margin expansion

EBITDA CAGR of 23% FY17-20E

Margin expansion led by higher value added products and operating leverage gains

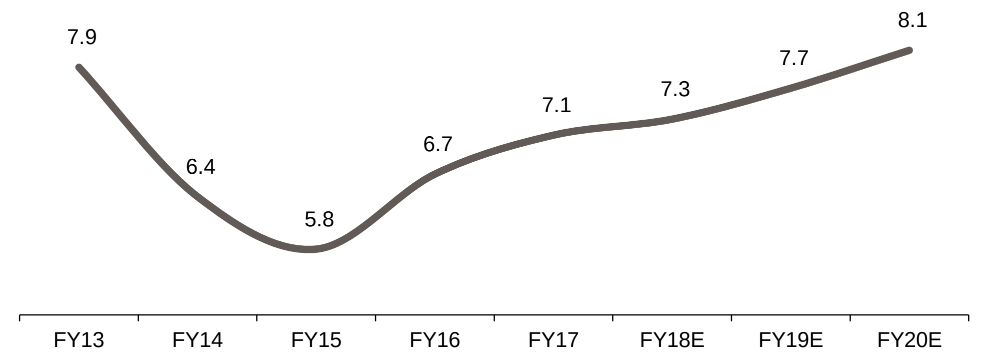
We expect APAT's EBITDA margin to rise to 8.1% in FY20 from 7.1% in FY17. This will be backed by increased sale of high-margin premium products and operating leverage gains. We expect APAT's 90% of product portfolio to become high-margin by FY20. This will be backed by introduction of DFT technology.

Exhibit 34: APAT's avg EBITDA/ton (Rs)



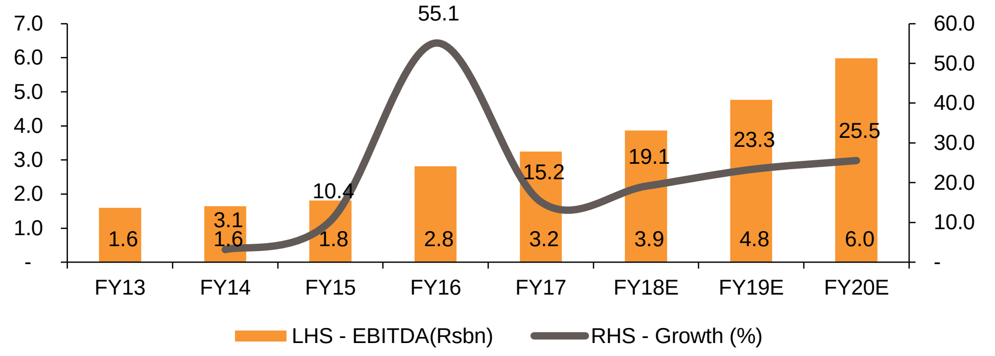
Source: Company, Emkay Research

Exhibit 35: APAT's EBITDA margin (%)



Source: Company, Emkay Research

Exhibit 36: APAT's EBITDA (Rsbn)



Source: Company, Emkay Research

Steel HR coil is the main raw material

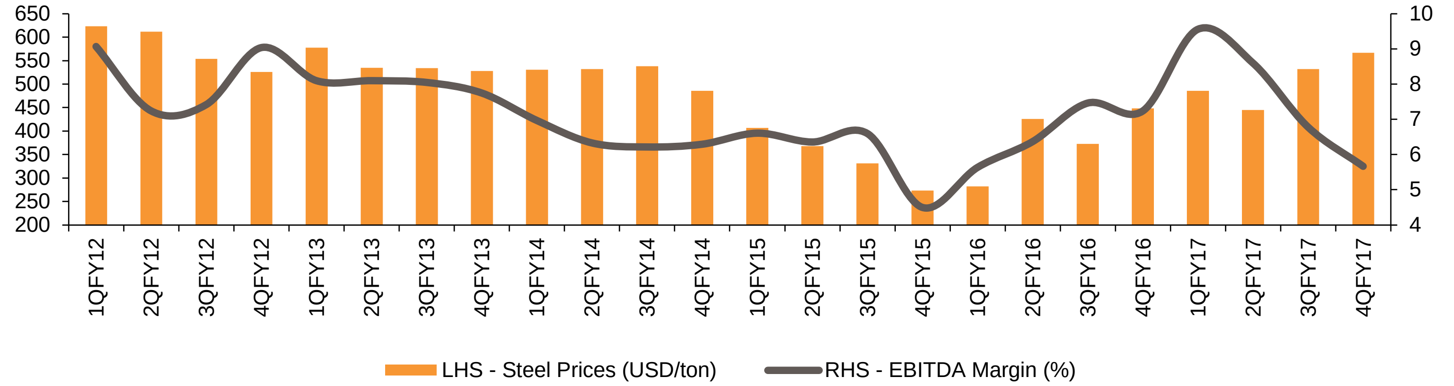
Strong pricing power

The EBITDA margins are slightly impacted by volatility in steel prices. Here is the analysis of responsiveness of margin to change in steel prices.

a) There is near perfect pass through of change in input cost to change in output prices; coefficient at 0.90 is almost close to 1

b) During recent periods (FY16-17) however, the average EBITDA expansion (11.2%) has been less than the average increase in steel price (20.2%). But the change in margin is still positive.

Exhibit 37: Quarterly steel prices vs APAT's quarterly EBITDA margin

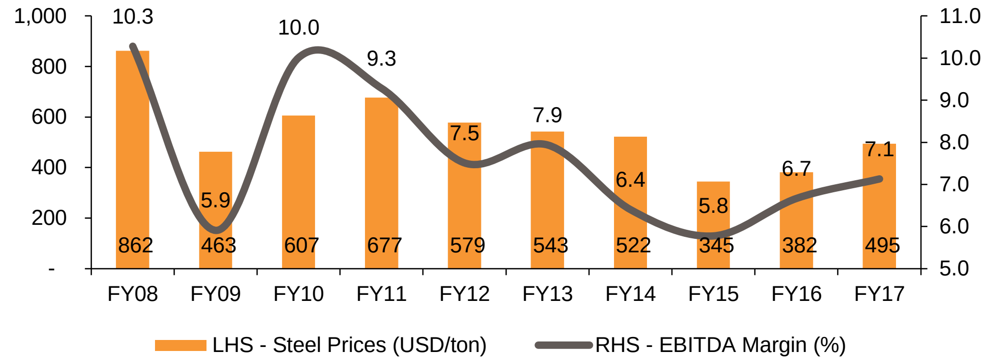


Source: Bloomberg, Company, Emkay Research

Margin expansion can be stronger in demand upcycle

Overall, while the sample is small (9 years), but it can reasonably be concluded that the company has strong pricing power. The expansion in margin can be stronger in a demand upcycle (e.g FY10).

Exhibit 38: Annual steel prices vs APAT's EBITDA margin

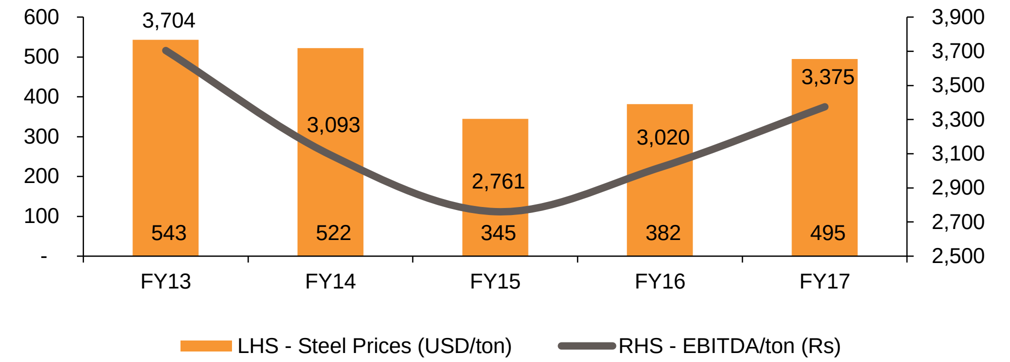


Source: Bloomberg, Company, Emkay Research

Margins are less volatile than peers

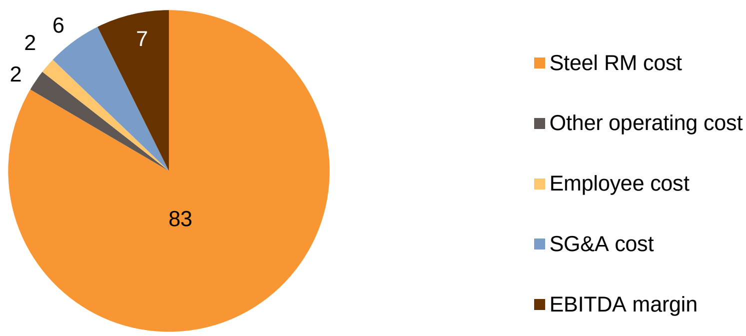
We are encouraged by the fact that the margins are not as volatile as APAT's peers. The margins have in fact seen an improvement in the past two years, led primarily by increasing stickiness of customers, and slightly better pricing power vs competition. The margins will get support going forward as share of DFT products increases as these will fetch higher margins than traditional ERW steel pipes.

Exhibit 39: Annual steel prices vs APAT's EBITDA spread



Source: Company, Emkay Research

Exhibit 40: APAT's cost as a % of revenue



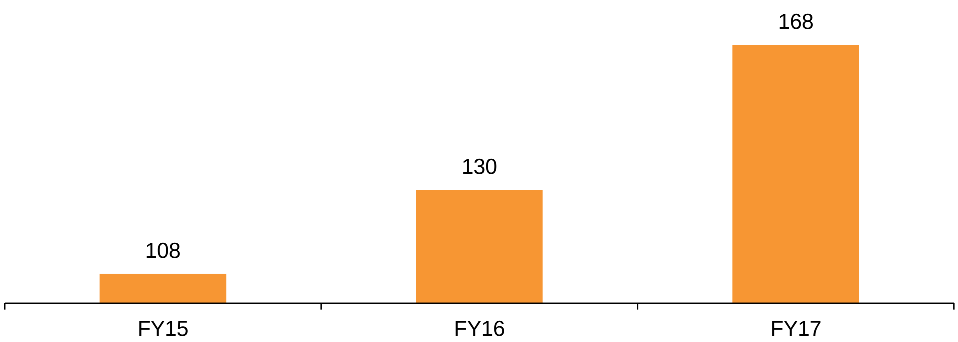
Source: Company, Emkay Research

Rising AS&P spends

Ad spends to enhance brand value

In 2013, APAT 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 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. APAT is targeting ~30k signage boards across the country for higher visibility. APAT has budgeted Rs250m (0.5% of FY17 revenue) for this branding exercise.

Exhibit 41: APAT's sales promotion expenses (Rsm)



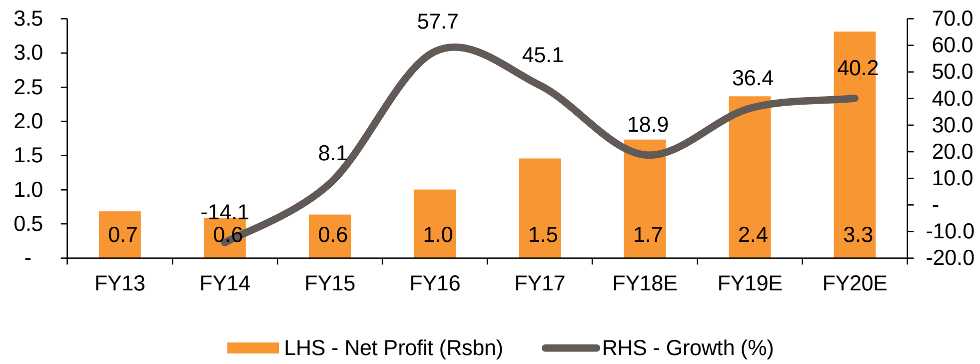
Source: Company, Emkay Research

4.3 Earnings CAGR of 31% over FY17-20E

Strong earnings growth through FY20

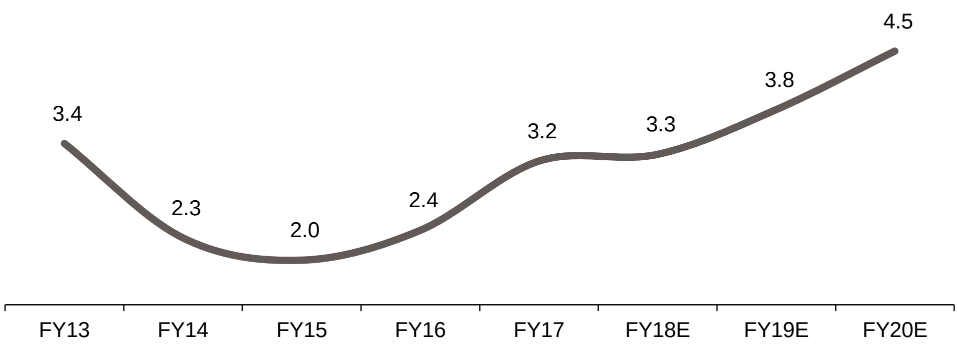
We forecast APAT's earnings to rise at 31% CAGR over FY17-20 backed by: 1) 17% revenue CAGR and, 2) EBITDA margin expansion of 100bps in next three years. The interest cost will decline by 50% due to strong cash flow generation and debt reduction.

Exhibit 42: APAT's net profit



Source: Company, Emkay Research

Exhibit 43: APAT's net margin (%)



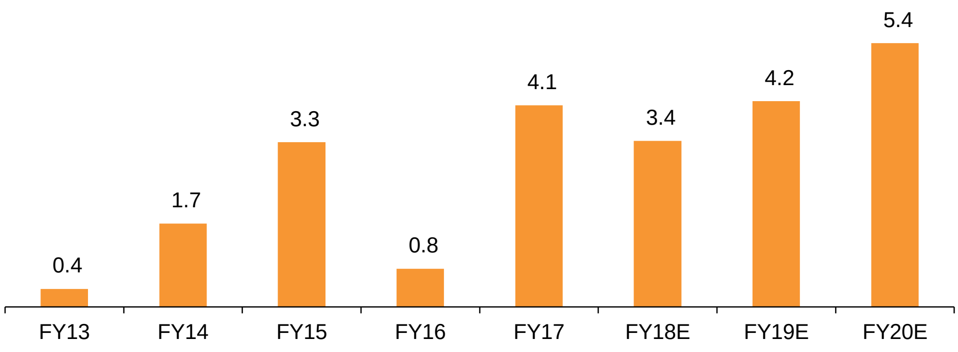
Source: Company, Emkay Research

4.4 Solid FCF generation and debt reduction

FCF generation of Rs2.9bn by FY20E

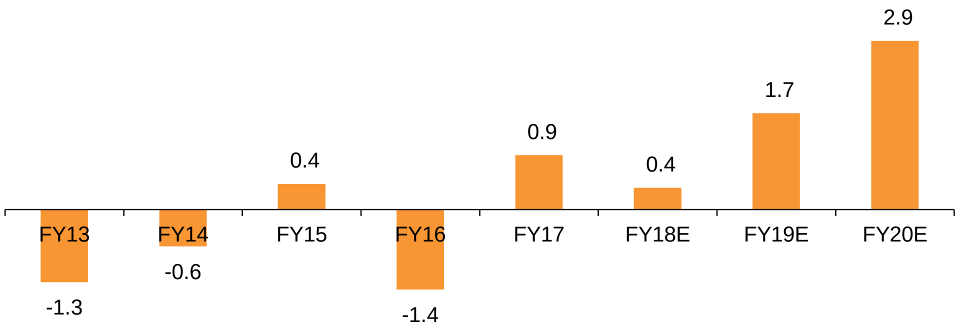
We expect SFL to continue to generate solid cash flows. This will be despite high capex spends. We expect OpCF to rise to Rs5.4bn in FY20E from Rs4.1bn in FY17. This will translate into total FCF of Rs5bn in FY18-20E. We have assumed FY18 capex of Rs1.5bn and FY19 capex of Rs800m.

Exhibit 44: APAT's operating cash flows (Rsbn)



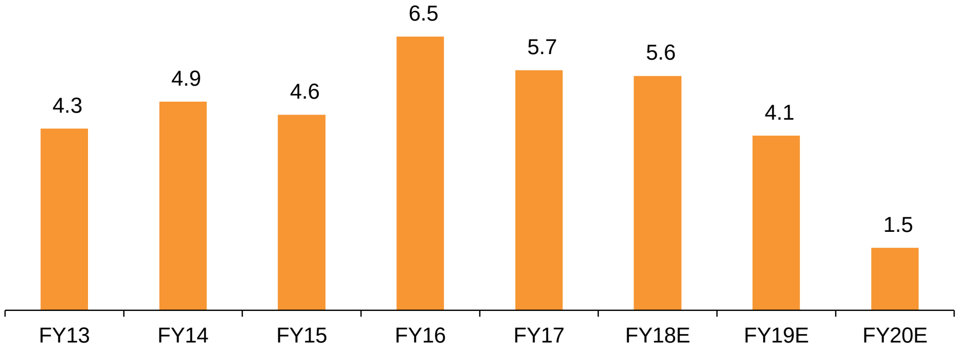
Source: Company, Emkay Research

Exhibit 45: APAT's free cash flows (Rsbn)



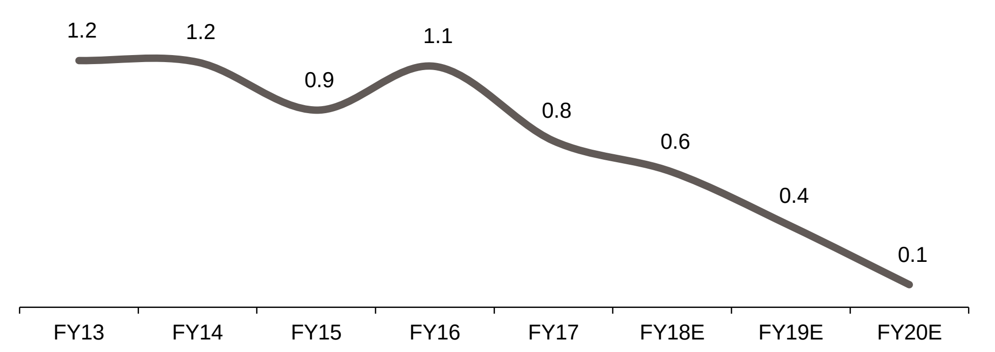
Source: Company, Emkay Research

Exhibit 46: APAT's net debt (Rsbn)



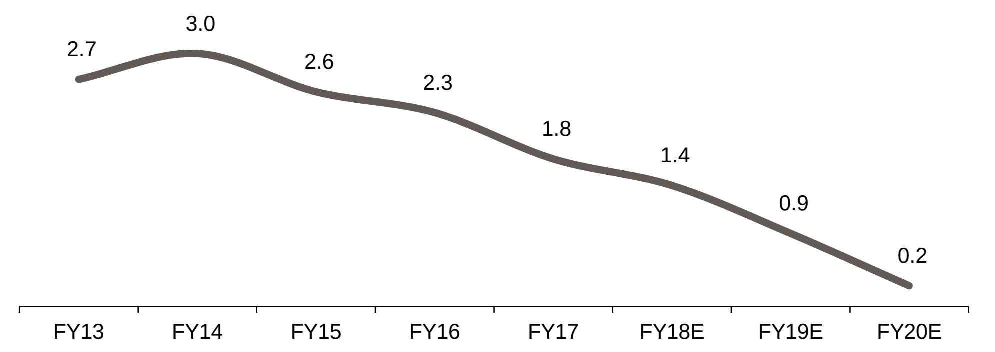
Source: Company, Emkay Research

Exhibit 47: APAT's D/E (x)



Source: Company, Emkay Research

Exhibit 48: APAT's Debt/EBITDA (x)



Source: Company, Emkay Research

Stable working capital cycle

Significant improvement in the past

APAT has improved its working capital cycle significantly over the past 5 years. With improving brand strength, APAT reduced debtor days from 40 in FY13 to 24 in FY17. It has also reduced inventory days via efficiencies in manufacturing and leveraging the distributed manufacturing initiative.

Exhibit 49: APAT's Working Capital Cycle (Days)

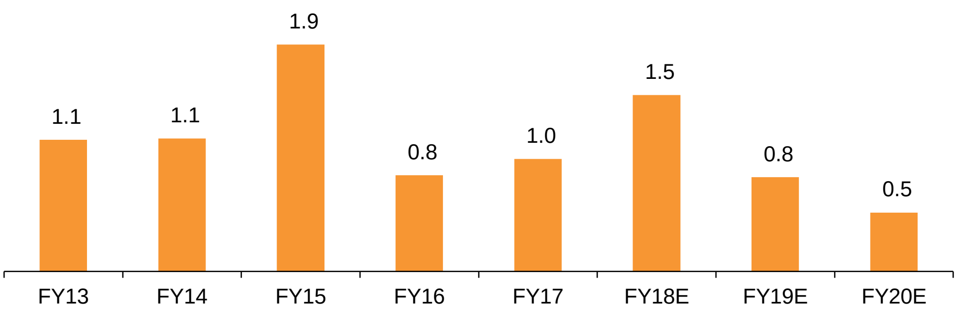
Working Capital Days	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Inventory	52	41	37	51	38	38	38	38
Debtor	40	35	20	19	24	24	24	24
Loans & advances	23	16	14	11	17	17	17	17
Other current assets	1	2	2	0	0	0	0	0
Payables	18	18	24	22	30	30	30	30
Current liabilities	2	2	4	5	7	7	7	7
Provision	6	4	3	4	1	1	1	1
Working capital days	**90**	**70**	**42**	**51**	**41**	**41**	**41**	**41**

Source: Company, Emkay Research

Ongoing capex is fully funded

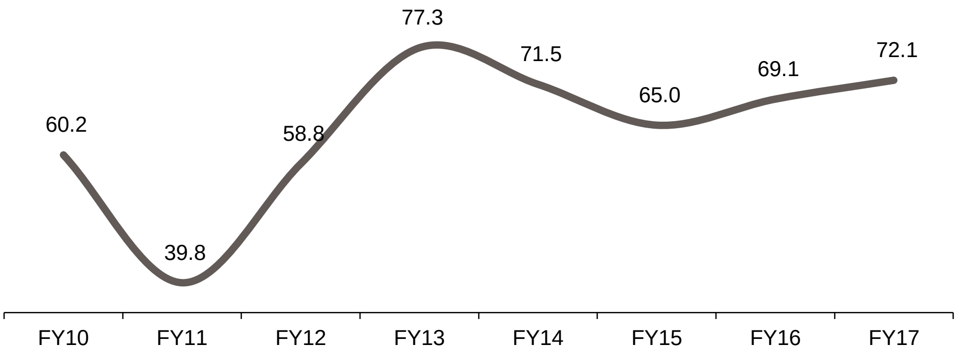
APAT is in process of increasing its capacity to 2m ton by FY18. The total capex requirement was Rs3.4bn. It has already spent Rs2bn as at Mar-17. The residual capex would be spent in FY18. This is all funded from the internal cash flows. We expect capacity utilization to reach 82.5% by FY20.

Exhibit 50: APAT's capex spend (Rsbn)



Source: Company, Emkay Research

Exhibit 51: APAT's capacity utilization (%)



Source: Company, Emkay Research

Further expansion to 2.5m ton by FY20

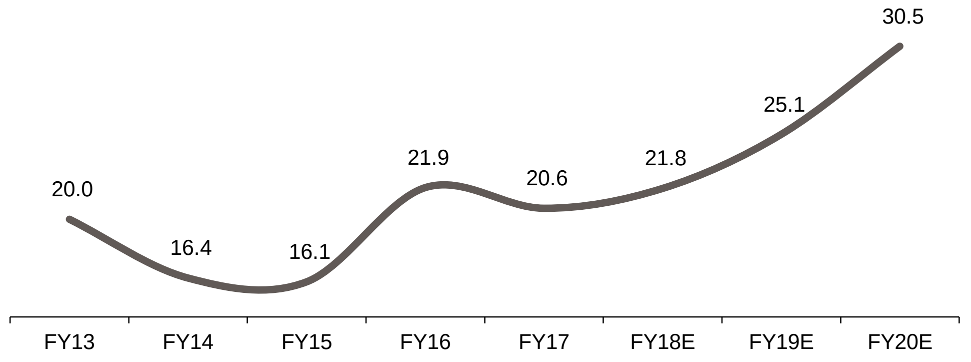
APAT plans to further increase its capacity to 2.5m ton by FY20. This will require new capex of Rs2bn. This can be easily funded from the internal cash flows. We have not factored this into our forecasts yet as we await for the final confirmation about timeline from the management.

4.5 Significant expansion in return profile

ROE/ROCE to improve in next 3 years

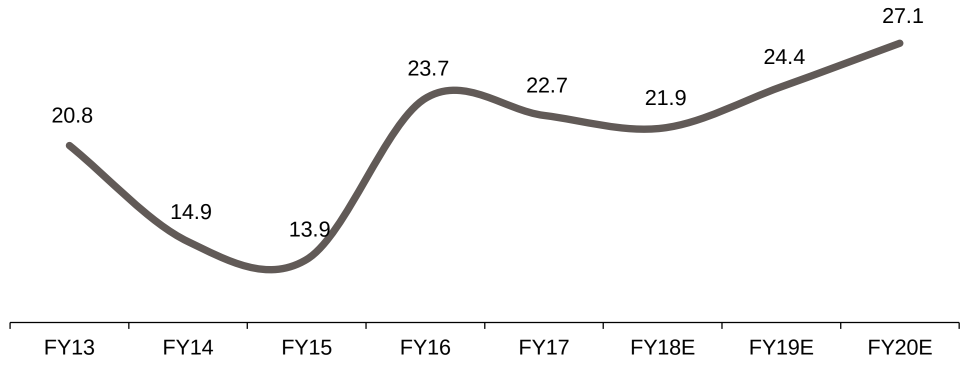
APAT's ROE has averaged 18.7% and ROCE has averaged 18.6% during FY12-17. The EBITDA margin expansion will further help improve profitability as well as return ratios. We expect ROCE to rise to 30.5% in FY20 from 20.6% in FY17. The ROE will rise to 27.1% from 22.7%.

Exhibit 52: APAT's ROCE (%)



Source: Company, Emkay Research

Exhibit 53: APAT's ROE (%)



Source: Company, Emkay Research

5.0 Valuation and share price analysis

Valued at 20x FY20E PER

We use PER methodology to value APAT as there is very strong earnings visibility. Moreover, it factors in the depreciation and interest costs as well. APAT is trading at a PER of 18x FY19E and 13x FY20E. In our view, there is no direct competition for valuation comparison. We recommend investors to look at APAT as a growth stock in India's construction and infrastructure space. In limited peer group, APAT has most superior earnings growth and ROE/ROCE profile. We value APAT on PER of 20x FY20E.

31% EPS CAGR, 27.1% ROE, 30.5% ROCE

Our target PER of 20x FY20E is justified by EPS CAGR of 31% and ROE/ROCE of 27.1%/30.5% by FY20E. We expect the stock to re-rate as the company delivers strong earnings growth backed by volume growth and margin expansion.

Exhibit 54: Peer valuation – Steel pipe companies

Companies	Mcap	EPS Growth (%)			PER (x)			EV/EBITDA (x)			P/BV (x)			ROE(%)		
	(USD m)	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Surya Roshni	228	20.6	18.7	-	18.5	15.6	-	8.0	7.3	-	1.8	1.6	-	9.8	10.6	-
Goodluck India	26	65.4	38.8	-	4.8	3.4	-	4.8	4.1	-	0.6	0.5	-	11.9	14.4	-
Maharashtra Seamless	491	22.7	20.7	-	17.8	14.8	-	8.8	7.4	-	1.1	1.0	-	6.1	6.9	-
Jindal Saw	584	12.5	18.5	-	10.9	9.2	-	6.7	6.2	-	0.6	0.6	-	5.9	6.5	-
Welspun Corp	583	301.2	97.5	-	35.6	18.0	-	8.2	7.1	-	-	-	-	3.8	7.1	-
Ratnamani Metals & tubes	630	15.4	17.5	27.8	24.5	20.9	16.3	13.2	11.3	9.2	3.1	2.8	2.4	13.2	13.8	15.6
Average		**73.0**	**35.3**	**27.8**	**18.7**	**13.7**	**16.3**	**8.3**	**7.2**	**9.2**	**1.4**	**1.3**	**2.4**	**8.5**	**9.9**	**15.6**
APL Apollo	**663**	**18.9**	**36.4**	**40.2**	**24.6**	**18.0**	**12.9**	**12.5**	**9.8**	**7.4**	**4.9**	**4.0**	**3.1**	**21.9**	**24.4**	**27.1**

Source: Bloomberg, Emkay Research

Trading at significant discount to building material sector average

We have also tried to compare APAT with some of the building material companies. The reason is that APAT's products are also used in the construction of residential and non-residential buildings. APAT's return profile is most superior in the pack. As the contribution from high-margin products increase in next 2 years, the valuation gap will also narrow down. Currently, APAT is trading at 40% disc to avg sector FY20E PER. Our target PER is 20x FY20E vs sector avg of 21.3x.

Exhibit 55: Peer valuation - Building material companies

Companies	Mcap	EPS Growth (%)			PER (x)			EV/EBITDA (x)			P/BV (x)			ROE(%)		
	(USD m)	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Somany Ceramics	546	4.5	41.9	18.7	35.2	24.8	20.9	18.2	14.1	12.8	5.7	4.8	4.2	17.4	20.9	21.6
Kajaria	1,654	9.1	26.6	22.9	38.9	30.7	25.0	21.1	17.5	14.6	7.7	6.4	5.4	21.4	22.8	23.2
HSIL	468	16.1	34.1	12.4	26.0	19.4	17.2	11.0	9.0	8.0	2.1	1.9	1.8	15.0	26.5	4.9
Greenply	542	10.8	14.0	-	25.1	22.0	-	15.2	12.3	-	-	-	-	16.9	17.4	-
Cera Sanitary ware	661	13.8	21.8	19.6	37.1	30.4	25.4	19.0	21.9	18.3	6.9	5.8	4.8	19.9	20.5	20.7
Shankara	526	264.7	22.8	46.9	43.1	35.1	23.9	19.7	17.0	13.3	7.3	6.1	5.0	17.6	18.2	23.1
Asian Granito	234	34.4	34.2	42.6	28.2	21.1	14.8	11.7	9.7	8.2	3.1	2.7	2.2	12.0	13.7	16.5
Average		**44.0**	**29.1**	**24.6**	**33.3**	**25.9**	**21.3**	**16.9**	**14.5**	**12.6**	**5.7**	**4.8**	**4.0**	**18.1**	**20.9**	**19.1**
APL Apollo	**663.4**	**18.9**	**36.4**	**40.2**	**24.6**	**18.0**	**12.9**	**12.5**	**9.8**	**7.4**	**4.9**	**4.0**	**3.1**	**21.9**	**24.4**	**27.1**

Source: Bloomberg, Emkay Research

BUY Recommendation with Rs2,812 TP

We initiate on APAT with a BUY rating. Although the stock has rallied in past 1 year, we believe that strong earnings growth and solid return profile are still not factored in the current valuations (13x PER FY20E). Our TP of Rs2,812 is based on PER methodology. Catalysts are new product launches, margin expansion and pick up in residential construction activity.

Risks to our recommendation

We see risks from following factors:

- APAT's realizations are slightly impacted by the volatility in steel prices. Its key raw material is HR coils, which is used to make pipes and tubes. But APAT has shown strength in the past to pass on the increase in steel prices to customers with a lag. So going forward with stronger brand, the margins should remain insulated to steel price volatility.
- APAT caters to different sectors of the Indian economy, which includes infrastructure, construction, automobile, energy, etc. Any slowdown in these sectors could have negative impact on the company's revenue growth.

6.0 Management Profile and Corporate Information

Key management personnel

Sanjay Gupta - Executive Chairman 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 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 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.

About the 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 1.3m ton spread out evenly across northern, southern, and western India. The company is commissioning 0.2m ton greenfield capacity at Raipur to cater to markets in eastern India. It is also adding lines of new DFT mills (0.5m ton) at existing sites in the four regions, which would enable it to offer superior products with lower turnaround times to customers.

APAT'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 625 dealers and 27 warehouses.

Key Financials (Consolidated)

Income Statement

Y/E Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	**42,136**	**45,450**	**52,730**	**61,913**	**73,430**
Expenditure	**39,319**	**42,206**	**48,866**	**57,149**	**67,451**
EBITDA	**2,817**	**3,244**	**3,863**	**4,763**	**5,980**
Depreciation	341	512	681	731	762
EBIT	**2,476**	**2,732**	**3,182**	**4,033**	**5,218**
Other Income	103	38	40	42	44
Interest expenses	695	683	633	543	312
PBT	**1,883**	**2,086**	**2,589**	**3,531**	**4,950**
Tax	624	627	854	1,165	1,634
Extraordinary Items	(253)	0	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	**1,006**	**1,459**	**1,735**	**2,366**	**3,317**
Adjusted PAT	**1,259**	**1,459**	**1,735**	**2,366**	**3,317**

Balance Sheet

Y/E Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Equity share capital	234	236	236	236	236
Reserves & surplus	5,442	6,967	8,419	10,502	13,535
Net worth	**5,677**	**7,203**	**8,655**	**10,738**	**13,771**
Minority Interest	**(1)**	**0**	**0**	**0**	**0**
Loan Funds	**6,506**	**5,707**	**5,807**	**4,307**	**1,637**
Net deferred tax liability	859	905	1,232	1,681	2,356
Total Liabilities	**13,040**	**13,815**	**15,694**	**16,725**	**17,764**
Net block	**6,662**	**7,345**	**9,389**	**9,458**	**9,196**
Investment	**131**	**127**	**140**	**154**	**170**
Current Assets	**9,488**	**9,803**	**11,600**	**13,494**	**15,965**
Cash & bank balance	14	17	248	166	159
Other Current Assets	48	60	68	79	91
Current liabilities & Provision	**3,561**	**4,685**	**5,435**	**6,381**	**7,566**
Net current assets	**5,927**	**5,118**	**6,166**	**7,114**	**8,399**
Misc. exp	0	0	0	0	0
Total Assets	**13,040**	**13,815**	**15,694**	**16,725**	**17,764**

Cash Flow

Y/E Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
PBT (Ex-Other income) (NI+Dep)	**1,780**	**2,049**	**2,549**	**3,489**	**4,906**
Other Non-Cash items	0	0	0	0	0
Chg in working cap	(2,041)	858	(489)	(582)	(616)
Operating Cashflow	**152**	**3,475**	**2,520**	**3,016**	**3,730**
Capital expenditure	(942)	(2,100)	(1,500)	(800)	(500)
Free Cash Flow	**(791)**	**1,375**	**1,020**	**2,216**	**3,230**
Investments	59	4	(13)	(14)	(15)
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	**(781)**	**(2,058)**	**(1,473)**	**(772)**	**(472)**
Equity Capital Raised	0	69	0	0	0
Loans Taken / (Repaid)	1,684	(798)	100	(1,500)	(2,670)
Dividend paid (incl tax)	(281)	(283)	(283)	(283)	(283)
Other Financing Cash Flow	(253)	283	0	0	0
Financing Cashflow	**455**	**(1,413)**	**(816)**	**(2,326)**	**(3,265)**
Net chg in cash	**(175)**	**3**	**231**	**(82)**	**(6)**
Opening cash position	188	14	17	248	166
Closing cash position	**14**	**17**	**248**	**166**	**159**

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY16	FY17	FY18E	FY19E	FY20E
EBITDA Margin	6.7	7.1	7.3	7.7	8.1
EBIT Margin	5.9	6.0	6.0	6.5	7.1
Effective Tax Rate	33.1	30.1	33.0	33.0	33.0
Net Margin	3.0	3.2	3.3	3.8	4.5
ROCE	21.9	20.6	21.8	25.1	30.5
ROE	23.7	22.7	21.9	24.4	27.1
RoIC	22.0	21.8	22.9	25.4	30.8

Per Share Data (Rs)	FY16	FY17	FY18E	FY19E	FY20E
EPS	53.7	61.8	73.5	100.3	140.6
CEPS	68.3	83.5	102.4	131.3	172.9
BVPS	242.2	305.3	366.9	455.2	583.8
DPS	10.0	10.0	10.0	10.0	10.0

Valuations (x)	FY16	FY17	FY18E	FY19E	FY20E
PER	34.5	29.9	25.2	18.5	13.2
P/CEPS	27.1	22.2	18.1	14.1	10.7
P/BV	7.6	6.1	5.0	4.1	3.2
EV / Sales	1.2	1.1	0.9	0.8	0.6
EV / EBITDA	17.7	15.2	12.7	10.0	7.6
Dividend Yield (%)	0.5	0.5	0.5	0.5	0.5

Gearing Ratio (x)	FY16	FY17	FY18E	FY19E	FY20E
Net Debt/ Equity	1.1	0.8	0.6	0.4	0.1
Net Debt/EBIDTA	2.3	1.8	1.4	0.9	0.2
Working Cap Cycle (days)	51.2	41.0	41.0	41.0	41.0

Growth (%)	FY16	FY17	FY18E	FY19E	FY20E
Revenue	34.3	7.9	16.0	17.4	18.6
EBITDA	55.1	15.2	19.1	23.3	25.5
EBIT	55.1	10.3	16.5	26.7	29.4
PAT	57.7	45.1	18.9	36.4	40.2

Quarterly (Rs mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18
Revenue	9,758	9,555	11,461	13,159	11,556
EBITDA	933	822	777	746	787
EBITDA Margin (%)	**9.6**	**8.6**	**6.8**	**5.7**	**6.8**
PAT	438	337	296	412	388
EPS (Rs)	**18.9**	**14.3**	**12.5**	**17.5**	**16.5**

Source: Company, Emkay Research

Shareholding Pattern (%)	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
Promoters	38.8	38.8	37.5	37.5	37.5
FIIs	0.6	0.5	0.4	-	-
DIIs	17.3	17.5	15.3	15.2	14.5
Public and Others	43.3	43.2	46.8	47.3	48.1

Source: Capitaline

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BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
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