COMPANY UPDATE

ISL & ASL

Sector Benefiting from Increasing Demand & High Margins

Equity Research | Engineering| Friday, 8 October, 2021

Our liking for the sector is mainly due to: 1) Gradual increase in consumer spending in all sectors 2) Increase in CRC-HRC margins 3) Support provided by the Government in the form of duty reductions in the FY22 budget and 4) Withdrawal of export rebate by Chinese Government

The margins are expected to ease down by the end of FY23, in the meantime due to high demand and supply constraints, any increase in the HRC prices will be passed on to the consumers

HRC-CRC Margins are Expected to Remain Elevated

Given the global supply chain disruptions, steel prices soared as production has not been able to meet the post-Covid demand. HRC prices clocked in at $1,100 per ton in June-21 as compared to $430 per ton in July-20. CRC-HRC margins stood at USD 107/ton (USD 87/ton 5 Year Average). These margins have been elevated amid high US infrastructure spending, withdrawal of 13.5% of export rebate provided by the Chinese government to its steel industry, tariff imposition due to USA-China trade war and lastly production cuts by China to overcome the pollution impacts. This results in high demand and low supply. The surge in steel prices is expected to continue during FY22, whereas prices are expected to ease down in FY23.

Recent Fiscal Measures to Support the Industry

The government has provided several duty relaxations to the flat steel players, primarily on the major raw material Hot Rolled Coil (HRC) required for the production of CRC. It includes:

- There will be no Additional Custom Duty on the import of steel raw material
- There will be a reduction in duties from 19.5% to 13% from China, whereas, for the rest of the world It stood at 6% from 12.5%. Further, the Customs duty of 5% has been revoked as well

On the other side despite the duty reductions, there will be drawbacks as well such as more HRC importers will become part of the flat steel market. As previously being CRC producer both ISL and ASL were benefited from a 6% duty differential on HRC imports as compared to other HRC importers. We also expect that anti-dumping duties on imported CRC will remain intact.

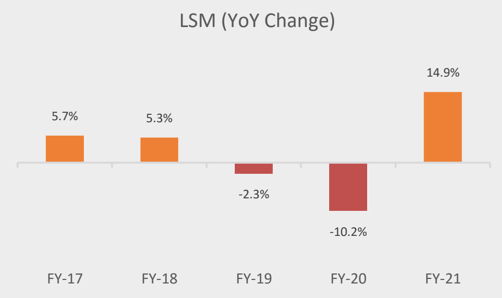
Surge in Demand

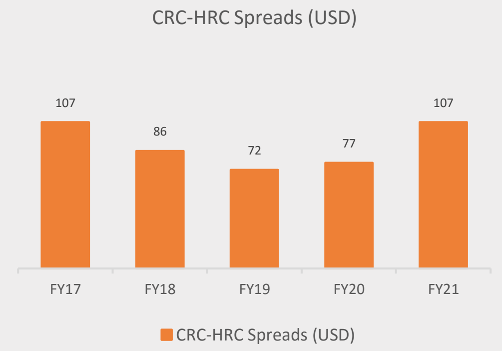
The extension in construction package by the government, plus the surge in demand from the private sector on the back of low-interest rates resultantly increased the demand for flat steel products. With the increase in global and local demand and surge in HRC prices, we expect that ISL and ASL will keep on passing the prices to the final consumer. Overall, the LSM index also posted a growth of 14.9% as compared to the decline of 10.2% last year. Further. The steel and auto industry has also posted a growth of 14.4% and 47.8% in 11MFY21. The construction package by the government coupled with the house financing scheme increased the demand for steel products. This urged the steel players to enhance their capacity.

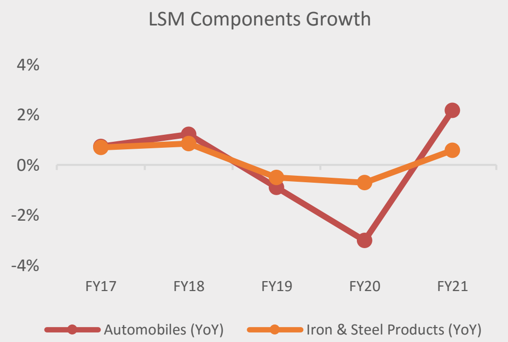
Withdrawal of Export Rebate by Chinese Government

Chinese Government has withdrawn the rebate of 13% given to all exporters of CRC & GI. This will positively impact the local market in a way that it will reduce the import of CRC and GI as China is the main exporter of such products in Pakistan. This will make the local players more competitive.

Key Statistics







Sources: ACPL Research, Company Financials, PSX,

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ISL

The scrip with attractive valuations offering a return of 69%

Equity Research | Engineering| Friday, 8 October, 2021

We initiate our coverage on International Steel Limited (ISL) with a DCF based Jun-22 TP of Rs.130 which provides an upside potential of 69%. A dividend yield of 12%, if incorporated gives a total return of 81%

The surge in International and Local steel prices, increase in demand, dominant position in the flat steel market, and the expansion of CRC plant by 120k tonnes will add sufficiently to the bottom line

Further, we expect the current anti-dumping duties on China and Ukraine will remain intact. Lastly, the possible venture of ISL regarding the in-house manufacturing of HRC will sufficiently reduce the raw material cost and support the margins

Company Overview

International Steel Limited is a public company incorporated in Pakistan under the Companies Act, 1913, (now the Companies Act, 2017). The principal activity of the Company is manufacturing, purchasing, and marketing Flat Steel products. ISL holds a vast, nationwide production and marketing infrastructure and produces leading CRC for local cultivation needs and demand. ISL is also a market leader in the Flat Steel market, which is marketed extensively across Pakistan. The ISL production facility is situated in Karachi.

Financial Performance

ISL has been able to grow its revenues and profitability at a 5-Year CAGR of 28% and 45% respectively in FY21. The Company posted its all-time high revenue of Rs. 69bn during the last fiscal year (45% up YoY). We have incorporated the expansion of 120k ton of CRC plant from FY23 onwards and expect that the company will be able to grow its revenue at a 5-Year CAGR of 20%. The gross margin stood at 19% as compared to 8.76% last year. Higher gross margin is attributed due to higher retention prices. We expect these margins to stabilize at a level 5-Year historical average of 14% by FY24. Currently, the D/E ratio of the company stands at 0.63x which is 51% lower as compared to its 5-Year historical average D/E of 1.29x. We expect that the company will be able to reduce its D/E ratio to 0.33x by FY25 which will significantly reduce the burden of finance cost from its bottom line.

Upcoming Expansions

To fulfill the rising demand, ISL is expanding its CRC production capacity by 120,000 tons per annum using the Temporary Economic Refinance Facility (TERF) and Long-Term Financing Facility offered by the SBP. This makes the total CRC capacity to 1,120k tons, whereas HDGC capacity stood at 462k tons. The project is expected to be completed in August 2022. Further, the management has completed the feasibility analysis for the in-house production of HRC. The estimated cost for this project is to be USD350mn. If this project is carried out successfully it will significantly reduce the raw material cost.

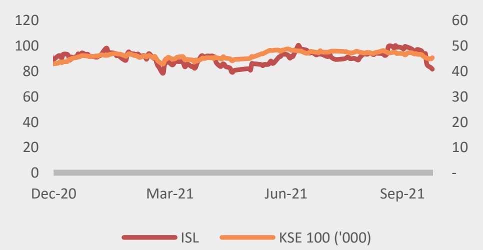
Valuation

ISL is currently trading at FY22E PE of 4.26x. Furthermore, the scrip is trading at a FY22E P/B of 2.49x which offers a discount of 37% relative to its historical 3-Year average of 3.96x. We have a BUY stance on the script with a DCF based Jun-22 TP of Rs 130 which provides an upside potential of 69%. A dividend yield of 12%, if incorporated gives a total return of 81%.

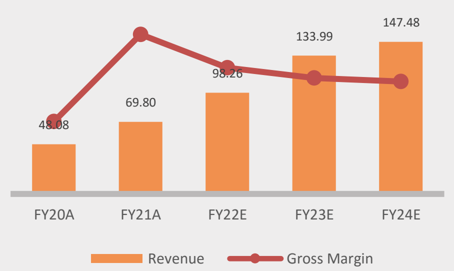
Key Statistics

Symbol	ISL
TP - Jun 22	130.00
LDCP	77.44
Upside (%)	69.00
Free Float ('mn)	152
Market Cap. (Rs.'mn)	33,647

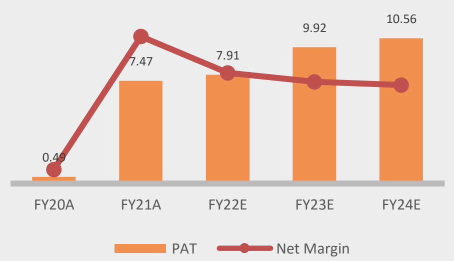
ISL vs KSE 100



Sales (Rs'bn) vs Gross Margin



PAT (Rs'bn) vs Net Margin



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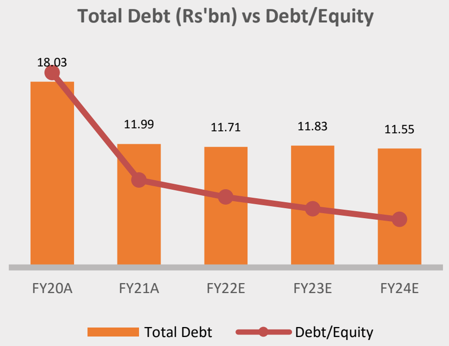
Key Statistics



Key Risks to Valuation

- More than expected depreciation of PKR
- More than expected rise in interest rate
- Removal of Anti-dumping duties on the import of CRC
- An unexpected decline in demand

Financial Projections

Rupees' millions	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Net sales	55,062	48,082	69,796	98,258	133,988	147,479	167,916
Cost of sale	48,613	43,869	56,304	83,253	115,166	127,387	147,082
Gross profit	**6,449**	**4,213**	**13,492**	**15,005**	**18,823**	**20,092**	**20,834**
Selling and promotion expenses	702	894	1,063	1,496	2,041	2,246	3,358
Administration expenses	284	263	362	509	694	764	870
Other operating expenses	534	334	1,277	1,965	2,680	2,950	3,358
Operating Profit	**4,929**	**2,721**	**10,791**	**11,034**	**13,408**	**14,132**	**13,247**
Other operating income	39	36	316	445	606	667	760
Finance cost	1,289	2,315	812	989	910	901	903
Profit before taxation	**3,679**	**442**	**10,295**	**10,490**	**13,105**	**13,899**	**13,104**
Taxation	1,015	- 53	2,828	2,581	3,188	3,342	3,115
Profit after taxation	**2,664**	**495**	**7,466**	**7,908**	**9,916**	**10,556**	**9,989**
EPS	**6.12**	**1.14**	**17.16**	**18.18**	**22.80**	**24.27**	**22.96**

Source: ACPL Research, Company Financials

Horizontal Analysis

	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Net sales	15.6%	-12.7%	45.2%	40.8%	36.4%	10.1%	13.9%
Cost of sale	21.4%	-9.8%	28.3%	47.9%	38.3%	10.6%	15.5%
Gross profit	**-14.8%**	**-34.7%**	**220.3%**	**11.2%**	**25.4%**	**6.7%**	**3.7%**
Selling and promotion expenses	61.6%	27.4%	18.9%	40.8%	36.4%	10.1%	49.5%
Administration expenses	-0.3%	-7.6%	37.6%	40.8%	36.4%	10.1%	13.9%
Other operating expenses	-19.3%	-37.4%	281.9%	53.9%	36.4%	10.1%	13.9%
Operating Profit	**-21.7%**	**-44.5%**	**302.9%**	**3.3%**	**22.1%**	**5.6%**	**-5.4%**
Other operating income	-73.8%	-9.9%	789.1%	40.8%	36.4%	10.1%	13.9%
Finance cost	139.2%	79.5%	-64.9%	21.8%	-8.0%	-1.0%	0.3%
Profit before taxation	-36.6%	-88.0%	2228.2%	1.9%	24.9%	6.1%	-5.7%
Taxation	-29.5%	-105.2%	-5468.8%	-8.7%	23.5%	4.8%	-6.8%
Profit after taxation	**-39.0%**	**-81.4%**	**1408.8%**	**5.9%**	**25.4%**	**6.5%**	**-5.4%**
EPS	**-39.0%**	**-81.4%**	**1408.8%**	**5.9%**	**25.4%**	**6.5%**	**-5.4%**

Source: ACPL Research, Company Financials

Key Ratios

Profitability Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
GP Margin	%	11.71	8.76	19.33	15.27	14.05	13.62	12.41
OP Margin	%	4.84	1.03	10.70	8.05	7.40	7.16	5.95
NP Margin	%	9.02	5.73	15.91	11.68	10.46	10.04	8.34
ROE	%	21.57	3.87	47.24	37.90	39.16	34.68	28.08
ROCE	%	23.13	14.29	43.79	41.38	45.20	41.08	33.87
ROA	%	14.32	2.35	33.41	28.90	26.61	23.00	18.47

Liquidity Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Current	x	1.09	0.94	1.38	1.45	1.49	1.65	1.75
Acid-test	x	0.20	0.22	0.17	0.21	0.14	0.24	0.29

Activity Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Inventory Turnover	x	3	3	3	4	4	3	4
Inventory Days		110	126	111	111	111	111	111
Receivables Days		6	8	5	5	5	5	5
Payables Days		42	74	43	50	50	50	50
Operating Cycle		74	59	73	66	66	66	66

Investment Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
EPS	Rs.	6.12	1.14	17.16	18.18	22.80	24.27	22.96
DPS	Rs.	3.00	0.00	10.00	9.09	11.40	12.13	11.48
Div. Yield	%	3.87	0.00	12.91	11.74	14.72	15.67	14.83
Dividend Cover	x	2.04	-	1.72	2.00	2.00	2.00	2.00
BVPS	Rs.	29.61	29.25	43.42	52.51	63.91	76.04	87.52
Payout	%	48.98	0.00	58.26	50.00	50.00	50.00	50.00
Retention	%	51.02	100.00	41.74	50.00	50.00	50.00	50.00
No. of Shares	'm	435	435	435	435	435	435	435
P/E	x	12.64	68.07	4.51	4.26	3.40	3.19	3.37
Sales per share		126.58	110.53	160.45	225.88	308.02	339.03	386.01
P/BV		4.42	4.47	3.01	2.49	2.05	1.72	1.49
Price to Sales		0.61	0.70	0.48	0.34	0.25	0.23	0.20

Gearing Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Debt to Equity	x	1.36	1.42	0.63	0.51	0.43	0.35	0.33
L.T. Debt to Equity	x	0.57	0.51	0.27	0.16	0.08	0.02	0.01
Interest Cover	x	3.85	1.19	13.68	11.61	15.40	16.43	15.51

Source: ACPL Research, Company Financials

COMPANY UPDATE

ASL

The scrip with attractive valuations offering a return of 90%

Equity Research | Engineering| Friday, 8 October, 2021

We initiate our coverage on Aisha Steel Limited (ASL) with a DCF based Jun-22 TP of Rs.40 which provides an upside potential of 90%. A dividend yield of 5%, if incorporated gives a total return of 95%

The surge in International and Local steel prices, increase in demand, second largest position in the flat steel market, and the expansion of Rolling and Galvanizing capacity will add sufficiently to the bottom line

Further, we expect the current anti-dumping duties on China and Ukraine will remain intact as it was supposed to come to an end on 13 Jan 2021 but on contrary ASL has already filed review at NTC for re-imposition of the same duty structure on China and Ukraine. NTC has already commecned anti-dumping proceeds against South Korea, Eurpoean Union and Taiwan

Company Overview

Aisha Steel Limited incorporated in Pakistan under the Companies Act, 1913, (now the Companies Act, 2017). The principal activity of the Company is manufacturing, purchasing, and marketing Flat Steel products. ASL holds a vast, nationwide production and marketing infrastructure and produces leading CRC for local cultivation needs and demand. The company marketed extensively across Pakistan. The Company production facility is situated in Karachi.

Financial Performance

ASL has been able to grow its revenues and profitability at a 5-Year CAGR of 31% and 44% respectively in FY21. The Company posted its all-time high revenue of Rs. 55bn during the last fiscal year (85% up YoY). We expect that the company will be able to grow its revenue at a 5-Year CAGR of 10% amid increase in prices and demand. Further, auto sector is a major market for flat steel players and it showed a growth of 62% in FY-21. The gross margin stood at 20.29% as compared to 7.95% last year. Higher gross margin is attributed due to higher retention prices. We expect these margins to stabilize at a level 5-Year historical average of 14% by FY27. Currently, the D/E ratio of the company stands at 0.93x which is 57% lower as compared to its 5-Year historical average D/E of 2.15x. We expect that the company will be able to reduce its D/E ratio to 0.11x by FY25 which will significantly reduce the burden of finance cost from its bottom line.

Recent Expansion to Boost up the Profitability

To fulfill the rising demand, ASL has recently expanded its Rolling and Galvanization capacity from 226k tons and 71k tons to 700k tons and 250k tons respectively. Currently, the utilization level is below 50% due to unavailability of the entire capacity during the year due to fire accident at the facility. However, we expect the utilization level to improve significantly once the entire capacity comes online.

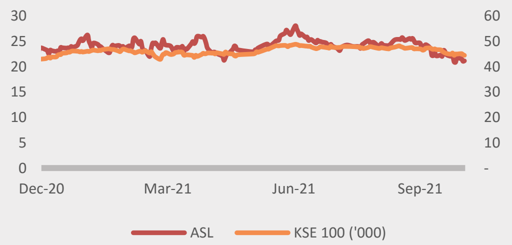
Foreign Company Validated the Value of ASL

ASL and a Japanese company Marubeni-Itochu Steel have entered into a strategic alliance and have signed a trade development agreement in order to expand the steel business in Pakistan. Additionally, the Japanese company has purchased around 38mn ordinary shares of ASL from Arif Habib Corporation Limited at a price of Rs.30. Considering the said transaction, it can be assumed that the intrinsic value of the share of ASL is at least Rs.30 as per the fundamentals of the company.

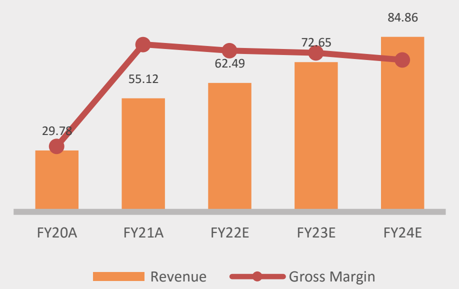
Key Statistics

Symbol	ASL
TP - Jun 22	40.00
LDCP	21.16
Upside (%)	90.00
Free Float ('mn)	152
Market Cap. (Rs.'mn)	33,956

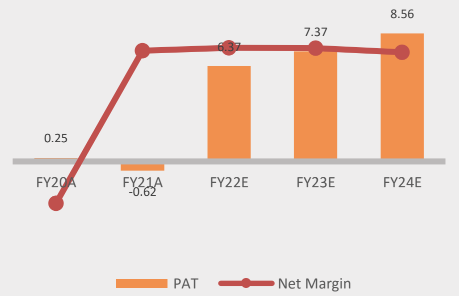
ASL vs KSE 100



Sales (Rs'bn) vs Gross Margin



PAT (Rs'bn) vs Net Margin



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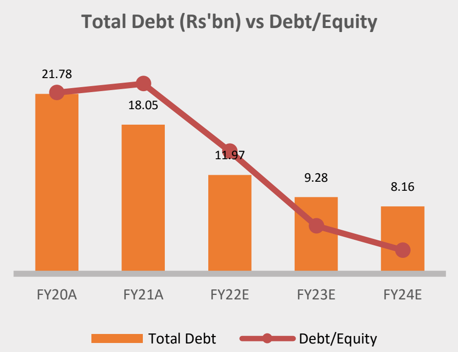
Key Statistics



Valuation

ASL is currently trading at FY22E PE of 2.2x. Furthermore, the scrip is trading at a FY22E P/B of 0.28x which offers a discount of 53% relative to its historical 3-Year average of 0.63x. We have a **BUY** stance on the script with a DCF based Jun-22 TP of Rs 40 which provides an upside potential of 90%. A dividend yield of 5%, if incorporated gives a total return of 95%.

Key Risks to Valuation

- More than expected depreciation of PKR
- More than expected rise in interest rate
- Removal of Anti-dumping duties on the import of CRC
- An unexpected decline in demand

Financial Projections

Rupees' millions	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Net sales	20,231	29,777	55,116	62,490	72,649	84,858	95,885
Cost of sale	18,553	27,411	43,931	50,274	58,637	69,232	79,202
Gross profit	**1,678**	**2,366**	**11,185**	**12,216**	**14,012**	**15,626**	**16,684**
Selling and promotion expenses	25	42	239	271	315	368	416
Administration expenses	249	320	357	404	470	549	621
Other operating expenses	3	-	977	1,108	1,288	1,504	1,700
Operating Profit	**1,401**	**2,005**	**9,613**	**10,432**	**11,939**	**13,204**	**13,948**
Other operating income	52	38	499	566	658	769	869
Finance cost	1,865	3,386	1,524	1,057	1,055	937	697
Profit before taxation	**3,679**	**442**	**10,295**	**10,490**	**13,105**	**13,899**	**13,104**
Taxation	**- 666**	**- 727**	**2,220**	**2,569**	**2,983**	**3,369**	**3,649**
Profit after taxation	**254**	**- 617**	**6,368**	**7,372**	**8,559**	**9,667**	**10,471**
EPS	**0.33**	**- 0.81**	**8.32**	**9.63**	**11.18**	**12.63**	**13.68**

Source: ACPL Research, Company Financials

Horizontal Analysis

	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Net sales	7.0%	47.2%	85.1%	13.4%	16.3%	16.8%	13.0%
Cost of sale	19.0%	47.7%	60.3%	14.4%	16.6%	18.1%	14.4%
Gross profit	**-49.4%**	**41.0%**	**372.7%**	**9.2%**	**14.7%**	**11.5%**	**6.8%**
Selling and promotion expenses	31.1%	67.1%	470.7%	13.4%	16.3%	16.8%	13.0%
Administration expenses	29.7%	28.2%	11.6%	13.4%	16.3%	16.8%	13.0%
Other operating expenses	-98.1%	-100.0%	0.0%	13.4%	16.3%	16.8%	13.0%
Operating Profit	**-21.7%**	**-44.5%**	**302.9%**	**3.3%**	**22.1%**	**5.6%**	**-5.4%**
Other operating income	46.3%	-26.2%	1207.7%	13.4%	16.3%	16.8%	13.0%
Finance cost	-72.9%	-81.5%	55.0%	30.6%	0.2%	11.2%	25.6%
Profit before taxation	-121.5%	225.7%	-739.3%	15.8%	16.1%	12.9%	8.3%
Taxation	205.5%	-9.1%	405.4%	-15.8%	-16.1%	-12.9%	-8.3%
Profit after taxation	**-80.2%**	**-343.0%**	**-1132.9%**	**15.8%**	**16.1%**	**12.9%**	**8.3%**
EPS	**-80.2%**	**-343.0%**	**-1132.9%**	**15.8%**	**16.1%**	**12.9%**	**8.3%**

Source: ACPL Research, Company Financials

Key Ratios

Profitability Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
GP Margin	%	8.30	7.95	20.29	19.55	19.29	18.41	17.40
OP Margin	%	7.18	6.86	18.35	17.60	17.34	16.47	15.45
NP Margin	%	1.25	-2.07	11.55	11.80	11.78	11.39	10.92
ROE	%	2.94	-7.31	60.71	44.58	34.93	28.76	23.97
ROCE	%	5.47	6.64	33.37	29.02	27.49	27.89	27.01
ROA	%	0.95	-2.01	21.02	19.45	18.68	19.29	19.09

Liquidity Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Current	x	0.06	0.06	0.13	0.41	0.40	0.49	0.53
Acid-test	x	0.67	0.61	0.90	2.46	2.35	2.92	3.17

Activity Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Inventory Turnover	x	3	5	6	3	3	3	3
Inventory Days		136	75	45	105	105	105	105
Receivables Days		11	6	4	10	10	10	10
Payables Days		24	33	42	30	30	30	30
Operating Cycle		123	48	6	85	85	85	85

Investment Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
EPS	Rs.	0.33	-0.81	8.32	9.63	11.18	12.63	13.68
DPS	Rs.	0.00	0.00	2.00	2.32	2.69	3.04	3.29
Div. Yield	%	0.00	0.00	4.96	5.75	6.67	7.54	8.16
Dividend Cover	x	0.00	0.00	4.16	4.16	4.16	4.16	4.16
BVPS	Rs.	32.26	29.99	47.39	74.58	106.15	141.80	180.42
Payout	%	-	-	24	24	24	24	24
Retention	%	100	100	76	76	76	76	76
No. of Shares	'm	271	271	271	271	271	271	271
P/E	x	12.83	69.06	4.58	4.32	3.45	3.24	3.42
Sales per share		74.62	109.82	203.28	230.48	267.95	312.98	353.65
P/BV		0.66	0.71	0.45	0.28	0.20	0.15	0.12
Price to Sales		0.80	0.54	0.29	0.26	0.22	0.19	0.17

Gearing Ratios		FY19A	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E
Debt to Equity	x	2.49	2.22	0.93	0.46	0.28	0.15	0.11
L.T. Debt to Equity	x	0.88	0.92	0.59	0.23	0.11	0.02	0.00
Interest Cover	x	0.78	0.60	6.63	10.40	11.94	14.92	21.27

Source: ACPL Research, Company Financials

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DEFINITION OF TERMS

TP	Target Price	CAGR	Compound Annual Growth Rate	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	LDCP	Last Day Closing Price

VALUATION METHODOLOGY

To arrive at our Target Price, Abbasi & Company (Private) Limited uses different valuation methods which include:

I. Discounted Cash Flow Model
II. Dividend Discount Model
III. Relative Valuation Model
IV. Sum of Parts Valuation

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HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
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Market Weight	Neutral
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