

01 Nov, 2022

Key Statistics

Sector	Engineering
Stance	BUY
Current market Cap (Rs. Bn)	29.19
Current Turnover	442.401
30 Days Average Volume (000)	492.76

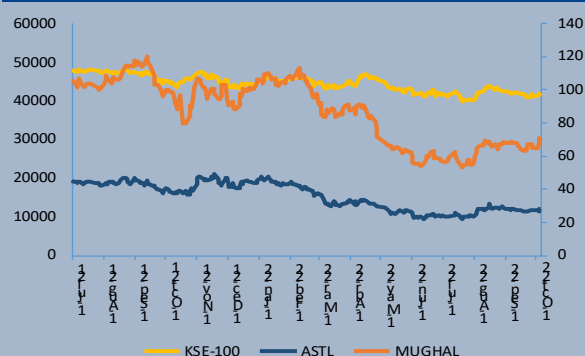
Source: PSX & WE Research

Long Steel Sector Snapshot

Rs. Bn	FY21A	FY22A	FY23F	FY24F
Sales	84.19	105.37	110.82	125.89
Cost	(72.96)	(90.70)	(95.40)	(110.85)
GP	11.23	14.67	15.41	15.04
GM (%)	13%	14%	14%	12%
Operating cost	(2.80)	(3.11)	(3.34)	(3.74)
other income	0.11	0.26	0.42	0.45
Finance Cost	(3.02)	(4.27)	(4.49)	(4.06)
Taxation	(0.75)	(0.81)	(2.60)	(1.80)
PAT	4.80	6.78	5.48	5.95
EPS	17.46	20.73	16.86	18.27

Source: Comp Accounts & WE Research

Relative Performance



Source: PSX & WE Research

Anjalee Pinjani
Research Analyst
Tel: 021-32410578
Email: anjali@we.com.pk

We reiterate coverage on Amreli Steel Limited (ASTL) & Mughal Iron & steel Industries (MUGHAL), maintaining buy stance and a discounted cash flow-based target price of PKR 33/share & PKR 79/share for Jun-23, presenting an upside potential of 39% & 31% respectively.

Long steel sector underperformed the benchmark KSE-100 by 23% during FY22TD posting a negative return of 35%, owing to 1) demand suppression 2) rising cost of construction due to high inflation 3) higher than expected surge in policy rate.

During FY22, revenue of long steel sector (ASTL & MUGHAL) improved by 25% YoY to PKR 105.37 bn on account of surge in local rebar prices by 52% YoY to Rs. 190K/ton while volumes remained under pressure (down 9%) owing to lower construction demand.

Global Scrap prices made a low of \$356/ton in Sept-22. During 1QFY23, cost of graded scrap have fallen by 34% QoQ to USD 380.51/ton compared to USD 510.08/ton SPLY owing to weak demand.

Moreover, local rebar prices stood at PKR ~223-225K/ton in Oct'22 but we anticipate prices to remain flat or decline by PKR 7-8K/ton during 2QFY23 due to declining scrap cost in the international market and ongoing PKR-USD recovery.

In near term we see long steel sector to remain under-pressure on the back of curtailed industrial activity, devastations caused by floods and an overall slowdown in economic activity. However, some rehabilitation activities expected in 1QFY24 can offset the impact.

Investment risk(s) to our valuation 1) higher than estimated prices of scrap steel 2) higher input costs 3) Lower than forecasted capacity utilization 4) unexpected PKR devaluation 5) uptick in interest rates 6) removal of tariffs on rebars.

Investment Perspective:

During FY22TD, long steel underperformed the benchmark KSE-100 index by 23% owing to sharp economic slump resulting in falling steel demand and delays in construction activities. Also rising energy, financing and super tax costs adds more pressure to sector profitability. However, in case of MUGHAL, exports of diversified product segment (non-ferrous) and dollar denominated income reduce the level of risk; where PKR-USD parity further boost the bottom-line owing to international copper ingots off-take. Exports from aluminium ingots will start from 1QFY24. In case of ASTL, company is venturing into non-ferrous segment (Aluminium Alloy) with initial product capacity of 18K MT to come online in FY24. As per our estimates, incremental impact on the earnings of ASTL is likely to be Rs1.3/share (~30% of earnings) from this Aluminium segment.

Expected lower scrap prices to uplift margins

International scrap prices are currently hovering around \$365-370/ton and made a low of \$356/ton in Sept-22. During 1QFY23, cost of graded scrap have fallen by 34% YoY (USD 380.51/ton compared to USD 510.08/ton SPLY). Going forward, we expect mean scrap prices to remain near the bottom where Russia-Ukraine war and multiple lockdowns in China leading to obstruction in steel consumption (6% MoM decline is witnessed). In the current conditions, buyers are not interested in overpaying for scrap metal, since weak demand, lower prices for metal products and rising energy costs already put many steel companies in a stalemate. Manufacturers cannot dramatically raise prices for steel products while production costs are rising.

Rebar Prices to decline or to remain flat owing to decline Scrap Costs

Local rebar prices fell by PKR 10K/ton MoM and currently hovering around PKR 223k to 225k/ton during Oct-22, in reaction to a decline in scrap prices by \$22/ton MoM and diminishing construction demand. Moreover, in the short term we expect rebar prices to remain flat owing to lower scrap prices and continuous PKR-USD depreciation along with rising fuel and finance cost reflecting long steel segment's ability to pass on the impact. However, in the medium term, rehabilitation activities in flood affected areas which will lift up the demand for girders and rebars which portends well for Mughal & ASTL bottom-line.

Finance Cost to Recede in the Medium Term for long steel

A sharp rise in policy rate of 800ps during FY22 has ballooned finance cost by 41% with net interest coverage ratio of 0.6x. Sector bottom-line is likely to further squeeze as interest rates and taxes are expect to remain at elevated levels throughout FY23. We expect a modest decrease in finance cost in FY23E following loosening of monetary policy while interest coverage to further squeeze at 0.22x in FY23E and 0.46x in FY24F on the back of declining margins.

Sector gross margins sustained near 11%

During 1QFY23, long steel sector gross margins sustained near 15% on the back of higher rebar (+18%QoQ) and copper prices (MUGHAL), which offset the impact of higher scrap and energy costs during the quarter. However, sector finance cost surged by 10% QoQ to PKR 882 mn (Sector's D/E Ratio 4.6x) owing to enhanced borrowings in order to meet WC requirements amid rising interest rates. Furthermore, the major reason for sectors' profitability decline is imposition of 10% super tax on 2022 profits along with additional 4% tax from 2023 onwards in the federal budget 2022-23.

"Going forward, we expect mean scrap prices to remain downward owing to lower demand outlook on the back of Russia-Ukraine war and multiple lockdowns in China."

"A sharp rise in policy rate of 800ps during FY22 has ballooned finance cost by 41% with net interest coverage ratio of 0.6x. "

Amreli Steel Limited (ASTL.PA) - BUY

Company Name:	Amreli Steel Ltd.
Bloomberg	ASTL.PA
Reuters	ASTL
Target Price	33/share
Upside	39%
Key Statistics	
Current Price*	24.35
Outstanding Shares	297.01 mn
52 Week High	48.54/-
52 Week Low	21.93/-
Market Capitalization*	6.98 bn
30 Day Avg. Volume	0.175mn
Valuation Methodology	DCF
Free Float	74.25 mn

*Price as of 31 Oct, 2022

Key Metrics					
	FY20A	FY21A	FY22A	FY23E	FY24F
Sales (Bn)	26.53	39.22	58.18	55.89	65.68
GPM	7%	12%	11%	11%	12%
EPS (PKR)	(4.18)	4.61	4.46	3.28	4.83
BPS (PKR)	36	29	25	23	15
CR	0.98	0.97	1.00	0.86	0.87
NPM	-4.7%	3%	2.3%	2%	2.2%
ROA (%)	-4%	4%	3%	2%	3%
ROE (%)	-11%	10%	9%	6%	6%
DR	69%	62%	65%	64%	59%
P/E*	(5.62)	5.10	5.27	7.17	4.86
P/B*	0.66	0.82	0.94	1.04	1.55

*Price as of Oct 31, 2022

Source: Comp Accounts & WE Research

Maintaining BUY Stance: We reiterate coverage on ASTL, with a BUY rating and a DCF based TP of PKR 33/share for Jun-23, offering an upside potential of 39% from last closing. We have revisited our investment case for ASTL where we have revised down our earnings forecast to PKR 3.28/4.83 per share for FY23E/FY24F. However, 37% slide during FY22TD has significantly diminished valuations as the stock trades at PE of 7.17x/4.86x and EV/EBITDA multiples of 2.79x/1.83x during FY23E/FY24F. Our conviction is based on 1) higher rebar prices 2) ability to pass on cost impact due to PKR-USD parity. We downgrade our valuation on ASTL as company has underperformed benchmark index by over 26% from its 52 weeks high/low PKR. 48.54/21.93 per share.

Profitability to Remain Under Stress due to Economic slowdown: Our earnings outlook projects decline in FY23E with a PAT of PKR 973 mn (EPS: 3.28PKR/share), down by 27%YoY, where earnings to grow by 10% at a 4 year CAGR and margins expansions.

During 1QFY23, ASTL's volumetric sales declined by 17% YoY owing to suspended production operations in order to manage cash-flows and inventories and further contraction is expected in 1HFY23 owing to demand contraction and rising cost of construction. Steel demand to recover from 2HFY23 onwards on the back of rehabilitation activities and gradual demand escalation from delayed projects, where we expect top-line to decline by 4% YoY in FY23E while growth normalization is expected from FY24 onwards aided by escalating steel prices (+23% YoY) to remain around PKR 234K/ton. Volumetric sales of graded rebars during FY23E to decline by 35% YoY and company would operate at 40% capacity utilization to sell 245K tons compared to 378K tons SPLY, resulting squeezing margins. Further, we expect GPM & NPM to reach at 11% & 2% respectively in FY23E.

ASTL venturing to Non-Ferrous Segment:

Amreli Steel Limited (ASTL) recently approved an investment to install production facility of Aluminium Alloy Ingots with an initial production capacity of 18K MT annually which is widely used in construction activities, electric Lighting, consumer goods and automotive Industry. Moreover, due to higher export potential of non-ferrous segment, we have assumed 100% exports of the commodity at US\$2300/ton initiating from 1QFY24. As per our estimates, incremental impact on the earnings of ASTL is likely to be Rs1.3/share (~30% of earnings) from this Aluminium segment.

Key Financial Highlights

PKR Billion	2020A	2021A	2022A	2023E	2024F	2025F	2026F
Net Sales	26.53	39.22	58.18	55.89	65.68	77.13	83.41
COGS	(24.72)	(34.68)	(51.69)	(49.69)	(57.80)	(68.65)	(74.24)
GP	1.81	4.54	6.49	6.20	7.88	8.48	9.18
Other income	0.01	0.05	0.02	0.01	0.01	0.01	0.02
Distribution cost	(0.68)	(0.95)	(1.20)	(1.25)	(1.46)	(1.71)	(1.85)
Administration expense	(0.50)	(0.55)	(0.74)	(0.85)	(0.99)	(1.16)	(1.25)
Finance Cost/Income	(2.30)	(1.65)	(2.31)	(2.84)	(2.99)	(3.23)	(3.21)
PAT	(1.24)	1.37	1.33	0.97	1.44	1.27	1.70
EPS (PKR)	(4.18)	4.61	4.46	3.28	4.83	4.28	5.74
PKR Billion	2020A	2021A	2022A	2023E	2024F	2025F	2026F
Share capital	2.97	2.97	2.97	2.97	2.97	2.97	2.97
Revenue reserve	2.79	2.79	2.79	7.02	9.39	11.66	14.42
Payables	3.73	5.08	6.24	7.40	9.18	10.34	10.77
Accrued markup	0.58	0.27	0.52	0.50	0.59	0.69	0.75
Short term borrowing	11.91	9.47	12.57	15.09	18.11	21.73	26.07
Current portion of long term loan	0.81	1.13	1.35	0.85	0.56	0.39	0.27
Stores & spares	1.68	1.46	2.76	2.84	2.92	3.01	3.10
Stock in trade	8.04	5.99	11.02	9.56	10.98	13.04	14.02
Receivables	4.90	6.32	5.68	7.23	7.46	9.37	9.80
Loans and advances	0.03	0.03	0.05	0.05	0.05	0.05	0.05
Other receivables	0.53	0.28	0.00	0.51	0.53	0.68	0.55
PP&E Intangibles	17.68	20.16	21.59	26.16	31.11	37.08	44.91
Total Assets	35.47	36.37	43.55	47.31	56.59	67.91	82.44
Key Ratios	2020A	2021A	2022A	2023E	2024F	2025F	2026F
EPS (PKR)	(4.18)	4.61	4.46	3.28	4.83	4.28	5.74
BPS (PKR)	36	29	25	23	15	14	7
Current Ratio (x)	0.98	0.97	1.00	0.86	0.87	0.91	0.97
Gross Margin (%)	7%	12%	11%	11%	12%	11%	11%
Net Margin (%)	-5%	3%	2%	2%	2%	2%	2%
ROA (%)	-4%	4%	3%	2%	3%	2%	2%
ROE (%)	-11%	10%	9%	6%	6%	4%	4%
Debt/Equity (%)	219%	161%	185%	176%	145%	122%	101%
Debt Ratio	69%	62%	65%	64%	59%	55%	50%
P/E (x)	(5.62)	5.10	5.27	7.17	4.86	5.49	4.09
P/B (x)	0.66	0.82	0.94	1.04	1.55	1.73	3.35
EV (billion)	7.71	7.23	7.25	11.10	9.67	10.05	6.94
EV/EBITDA (x)	14.24	2.44	1.65	2.79	1.83	1.85	1.18
EBITDA	0.54	2.96	4.39	3.98	5.29	5.44	5.88

Source: Company Accounts & WE Research

Comp Name:	Mughal Iron & steel Industries Ltd.
Bloomberg	MUGHAL.PA
Reuters	MUGHAL
Target Price	79/share
Upside	31%
Key Statistics	
Current Price*	60.50
Outstanding Shares	335.63 mn
52 Week High	112.86/-
52 Week Low	52.97/-
Market Capitalization*	20.31 bn
30 Day Avg. Volume	329 mn
Valuation Methodology	DCF
Free Float	83.91 mn

*Price as of 31 Oct, 2022
Source: PSX & WE Research

Key Metrics					
	FY21A	FY22A	FY23F	FY24F	FY25F
Sales (Bn)	44.97	66.15	71.60	86.67	86.36
GPM	15%	15%	15%	12%	12%
EPS (PKR)	12.85	16.12	12.25	13.66	14.05
BPS (PKR)	49.18	62.12	41.09	54.75	68.81
CR	0.82	0.96	1.05	1.22	1.60
NPM	8%	8%	6%	5%	5%
ROA (%)	8%	10%	10%	10%	9%
ROE (%)	21%	26%	30%	25%	20%
DR	48%	46%	51%	38%	27%
P/E*	4.71	3.75	4.94	4.43	4.31
P/B*	1.23	0.97	1.47	1.10	0.88

*Price as of Oct 31, 2022
Source: Comp Accounts & WE Research

Maintaining BUY Stance: We reiterate coverage on MUGHAL, with a BUY rating and a DCF based TP of PKR 79/share for Jun-23, offering an upside potential of 31% from last closing with expected earnings of PKR 12.25/share & PKR 13.66/share for FY23E & FY24F respectively. The scrip is trading at attractive earnings multiples of 4.94x/4.43x & P/B of 1.47x/01.10x for FY23E/ FY24F. Our investment case is based on i) robust demand from infrastructure (housing & construction) projects; ii) Mughal's diversified product portfolio (Ferrous & non-ferrous); iii) strong financial performance along with strong revenue growth; iv) efficient working capital; v) rising long steel products prices owing to rising demand in northern areas. We downgrade our valuation on MUGHAL as company has underperformed benchmark index by over 20% from its 52 weeks low Rs. 52.97/share.

Mounting total revenue owing to growing non-ferrous demand: Strong demand for copper on the back of growing dependence on renewable power and electric vehicles (EVs) leading to surge in copper prices. Copper prices are up by 7% YoY in FY22 recorded at USD 9.25K/ton against USD 8.69K/ton SPLY and are expected to hover around USD 8.2K-8.5K/ton during FY23E. Noticeably, internationally copper prices has fallen by 21% in the last 4 months recorded lowest at USD 7.2K/ton in Jul'22 vs USD 9.6K/ton owing to fears over a worldwide rising recession; hitting demand and currently hovering around USD 7.5K/ton in Oct'22. During FY23E, we have estimated company would operate above its capacity to sell 14k tons of copper Ingots at the average price of USD 8.2K/ton with an earnings contribution of 8/share or 38% in total earnings. Since last 2 years, non-ferrous segment is exponentially increasing, we expect the contribution of non-ferrous segment to grow 12% (4 years CAGR). Moreover, as per management company is targeting to diversify its non-ferrous segment by adding base metal of Aluminium Alloy Ingots exports from FY24. Hence, the nonferrous division to increase significantly in long term period.

Mughal's FY22E Performance and Improved margins Ahead: We expect MUGHAL's short term profit after tax to remain under stress on the back of slowdown construction activities amid floods. We expect revenue from ferrous (steel rebars, billets & girders) and non-ferrous (copper ingots) to decline by 20%YoY & 9%YoY, we believe company would operate at 27% & 59% capacity utilization to produce 158K tons & 14K tons of ferrous & non-ferrous products respectively. Overall top line to grow by 8%YoY to record at PKR 71.6 bn and gross margins to reach at 15% in FY23E on account of surge in steel Rebar prices by 23% to record at 234K/ton against 190K/ton SPLY amid PKR-USD devaluation by 23%YoY. Moreover, higher taxation and finance cost can hit company's bottom-line.

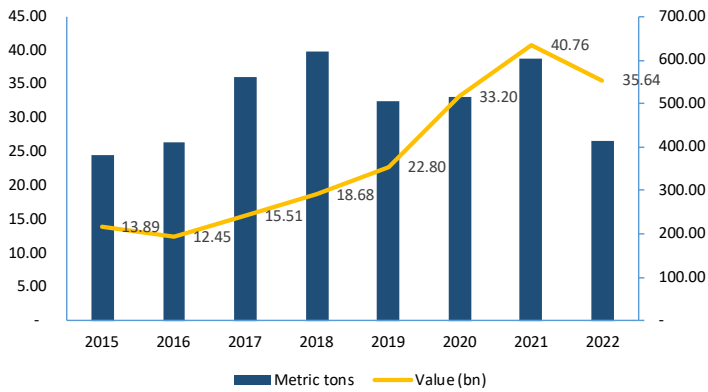
Key Financial Highlights

PKR Billion	2020A	2021A	2022A	2023F	2024F	2025F	2026F
Net Sales	27.30	44.97	66.15	71.60	86.67	86.36	92.67
COGS	(24.69)	(38.28)	(56.02)	(60.73)	(76.18)	(76.12)	(81.04)
GP	2.62	6.69	10.13	10.87	10.49	10.24	11.63
Other income	0.06	0.07	0.21	0.38	0.40	0.40	0.43
Distribution cost	(0.14)	(0.25)	(0.25)	(0.28)	(0.34)	(0.33)	(0.36)
Administration expense	(0.41)	(0.54)	(0.70)	(0.76)	(0.91)	(0.91)	(0.97)
Finance Cost/Income	(1.51)	(1.37)	(2.62)	(2.84)	(2.41)	(1.98)	(2.15)
PAT	0.59	3.43	5.41	4.11	4.58	4.72	5.50
EPS (PKR)	2.25	12.85	16.12	12.25	13.66	14.05	16.39
PKR Billion	2020A	2021A	2022A	2023F	2024F	2025F	2026F
Share capital	2.52	2.92	3.36	3.36	3.36	3.36	3.36
Capital reserve	1.42	7.14	6.32	10.43	15.02	19.74	25.24
Trade & other Payables	1.19	1.73	2.92	2.50	2.09	2.09	2.22
Accrued markup	0.36	0.25	0.38	0.32	0.28	0.21	0.19
Short term borrowing	11.58	16.11	20.62	17.76	15.98	14.38	12.95
Current portion of long term loan	0.82	0.77	1.28	0.31	0.37	0.02	0.01
Stores & spares	1.39	-	-	1.96	2.37	2.37	2.54
Stock in trade	8.12	14.87	22.96	14.71	14.96	14.91	15.99
Receivables	2.18	5.26	5.57	1.96	2.37	2.37	2.54
Long term Financing	2.64	3.91	4.03	2.88	1.50	0.20	0.12
Loans & Advances	0.28	0.14	0.15	0.22	0.26	0.26	0.28
PP&E Intangibles	9.92	15.80	16.46	18.44	20.00	21.86	23.96
Total Assets	25.61	41.80	53.09	40.69	45.72	53.41	58.84
Key Ratios	2020A	2021A	2022A	2023F	2024F	2025F	2026F
EPS (PKR)	2.25	12.85	16.12	12.25	13.66	14.05	16.39
BPS (PKR)	24	49	62	41	55	69	85
Current Ratio (x)	1.12	1.37	1.45	1.06	1.37	1.88	2.26
Gross Margin (%)	10%	15%	15%	15%	12%	12%	13%
Net Margin (%)	2%	8%	8%	6%	5%	5%	6%
ROA (%)	2%	8%	10%	10%	10%	9%	9%
ROE (%)	7%	21%	26%	30%	25%	20%	19%
Debt/Equity (x)	5.66	6.86	7.34	6.15	5.21	4.35	3.89
Debt Ratio	56%	48%	46%	51%	38%	27%	22%
P/E (x)	26.90	4.71	3.75	4.94	4.43	4.31	3.69
P/B (x)	2.49	1.23	0.97	1.47	1.10	0.88	0.71
EV (billion)	14.37	20.72	22.83	23.58	18.16	9.35	6.01
EV/EBITDA (x)	6.95	3.75	2.59	2.48	2.07	1.10	0.61
EBITDA	2.07	5.53	8.82	9.53	8.78	8.53	9.79

Source: Company Accounts & WE Research

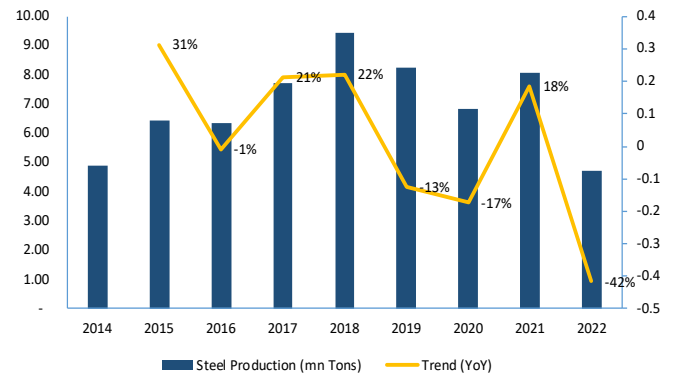
Yearly Import Scrap steel

Source: PBS & WE Research



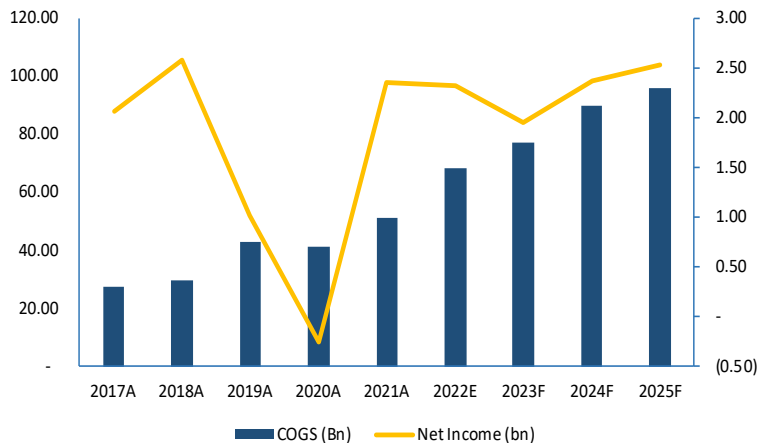
Pakistan Contribution in World Steel Production

Source: PBS & WE Research



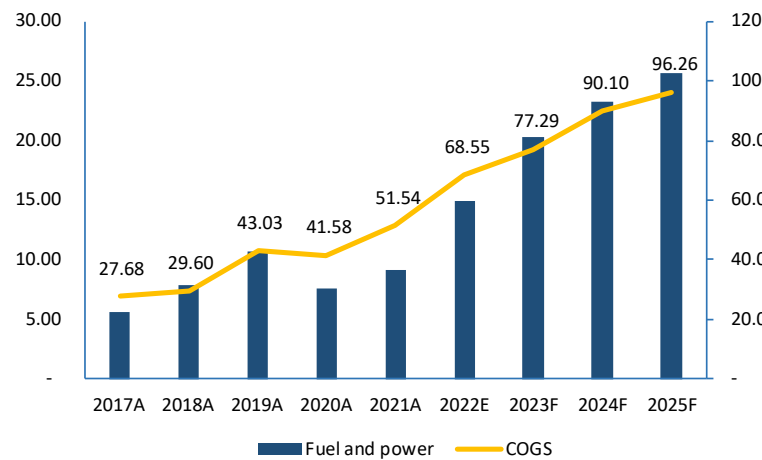
Sector's COGS converting into Net Income

Source: Comp Accounts & WE Research



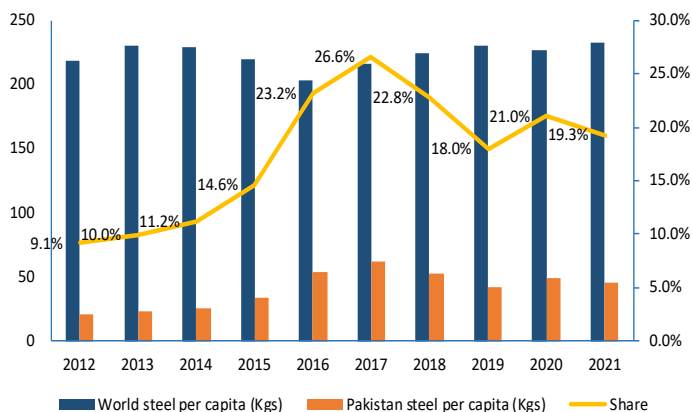
Sector's Energy costs Share in COGS

Source: (Comp Accounts & WE Research)



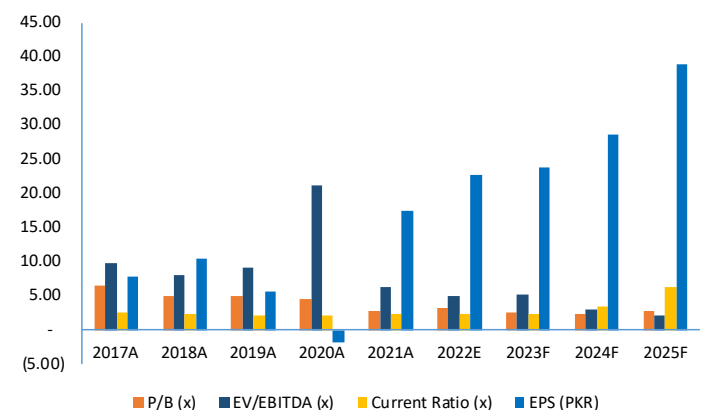
Pakistan's share in Per Capita Steel Consumption

Source: SSY & WE Research



Sector's Key Metrics

Source: Company Accounts & WE Research



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Stock Ratings

WE Financial Services Ltd. uses three rating categories, depending upon return form current market price, with Target period as June 2019 for Target Price. In addition, return excludes all type of taxes. For more details kindly refer the following table;

Potential to target price	
Buy Upside	More than +15% from last closing price
HOLD	In between -15% and +10% from last closing price
SELL	Less than -15% from last closing price

Equity Valuation Methodology

WE Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Relative valuation (P/E, P/B, P/S)
- Equity & Asset return based (EVA, Residual income)

Risks

The following risks may potentially impact our valuations of subject security(ies);

- Market Risk
- Interest Rate Risk
- Exchange rate risk

Disclaimer: This document has been prepared by Research analysts at WE Financial Services Ltd.