

PAKISTAN



FSL Steel Universe 2QFY22 Profitability Preview

	2QFY22	YoY	QoQ	1HFY22	YoY
MUGHAL	6.7	114%	15%	11.7	181%
ASTL	3.0	187%	28%	5.4	278%
AGHA	1.2	33%	24%	2.1	12%
ISL	5.1	1%	-16%	11.3	77%

FSL universe	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22E
GP Margin	16%	20%	18%	18%	17%
Net Margin	9%	11%	8%	10%	9%
Interest cover	5.7	5.5	4.5	6.0	6.1

MUGHAL	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22E
GP Margin	15%	21%	13%	20%	20%
Net Margin	9%	11%	6%	12%	12%
Interest cover	5.1	4.7	4.2	5.5	6.2

ASTL	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22E
GP Margin	11%	14%	11%	14%	14%
Net Margin	3%	5%	4%	6%	6%
Interest cover	1.8	2.5	2.1	3.2	4.1

AGHA	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22E
GP Margin	18%	21%	31%	23%	23%
Net Margin	10%	10%	10%	9%	10%
Interest cover	3.3	2.5	2.5	2.7	3.4

ISL	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22E
GP Margin	20%	24%	24%	18%	15%
Net Margin	12%	14%	12%	11%	9%
Interest cover	18.4	22.2	14.8	21.6	15.8

Dividend expectations (Rs/sh)

ISL	4.0
MUGHAL	1.5
ASTL	-
AGHA	-

Source: Company Accounts, Foundation Research, Jan 2022

Analyst

Usman Arif usman.arif@fs.com.pk
 +92 21 35612290 Ext 339

Foundation Securities (Pvt) Ltd
 Wednesday, January 19, 2022

Pakistan Steel

Profitability surges to make new record in 2QFY22

Event

▪ FSL steel universe profitability is expected to increase by 48% YoY towards quarterly new high of Rs6.1bn in 2QFY22. Increase in profitability is attributable to (1) better retention prices in both flat and long steel products amid higher volumes, (2) higher profitability of MUGHAL non-ferrous (copper) segment and (3) increased pricing power in flat steel market amid recovery in HRC-CRC margins. Among individual companies MUGHAL/ASTL/AGHA profitability is expected to increase by 114/187/33% YoY in 2QFY22. However, ISL profitability growth is expected to show muted growth of 1% YoY in 2QFY22 due to non-cash inventory loss adjustment given ~17% QoQ decline in HRC prices as company utilized supplier credit facility to build inventory levels.

Impact

▪ **Profitability to make new high due to pricing power and MUGHAL's copper exports:** FSL steel universe sales are expected to increase by 49/17% YoY/QoQ in 2QFY22 due to better retention prices for both long/flat steel players given multiple price hikes and higher volumes. We attribute increase in profitability to (1) increased pricing power of flat steel players given restricted imports due to higher HRC/CRC margins and (2) start of price increase cycle for long steel players due to close coordination between industry players to pass on the impact of hike in scrap cost (up 43/2% YoY/QoQ) in 2QFY22.

▪ **Non-ferrous segment earnings growth to dominate MUGHAL's profitability:** MUGHAL profitability is expected to increase by 114/15% YoY/QoQ to Rs6.7/sh in 2QFY22. Increase in profitability would come from (1) higher realized prices for copper ingot exports (up 33/2% YoY/QoQ) amid rupee devaluation, (2) decline in discount offered from LME price due to increased portion of direct exports to customers in China and (3) higher rebar sales given addition of 430K tons new mill amid better retention prices.

▪ **ASTL profitability growth continue to outperform peers:** We expect ASTL profitability to increase by 187/28% YoY/QoQ to Rs3.0/sh in 2QFY22. Company profitability would increase due to (1) better rebar retention prices, (2) decline in operating cycle given pricing power and higher growth in south region and (3) lower provision for doubtful debt.

▪ **Volumetric constraints to restrict upside in profitability:** AGHA is expected to report EPS of Rs1.2 (up 33/24% YoY/QoQ) in 2QFY22. We attribute increase in company's profitability to higher retention prices as volumetric growth of AGHA remained restricted in 2QFY22 due to delay in COD of new rebar mill.

▪ **Inventory loss adjustment to restrict profitability growth of ISL:** Inventory loss adjustment due to decline in HRC prices by ~17% QoQ would restrict ISL profitability growth to 1% YoY in 2QFY22. To highlight, ISL inventory level increased to Rs28.1bn at the end 1QFY22 as company utilized the supply credit facility (interest free ~Rs11bn) to build inventory levels.

Outlook

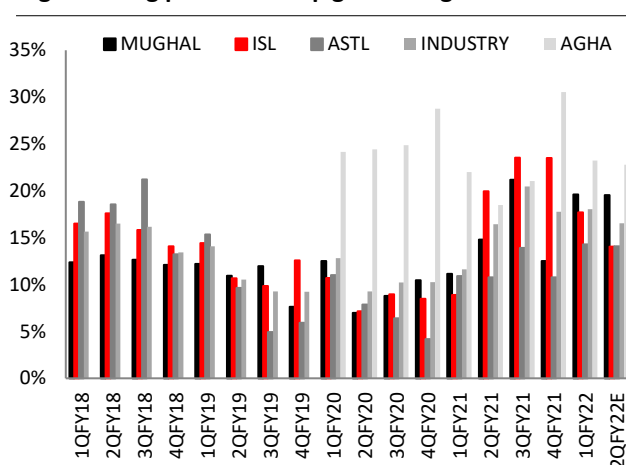
▪ We have a positive stance towards the sector given (1) listed players' greater financial muscle as compared to ungraded players in rebar segment, (2) price increase cycle in rebar market and (3) reduced share of private importers in flat steel market.

Fig 1: 2QFY22E FSL Steel Universe Financial Highlights (Rs mn)

	2QFY22	2QFY21	YoY	QoQ	1HFY22	1HFY21	YoY
Net Sales	66,096	44,344	49%	17%	122,597	80,692	52%
Cost of Sales	54,912	37,047	48%	19%	101,209	69,170	46%
Gross Profit	11,184	7,297	53%	10%	21,388	11,522	86%
Administrative expenses	496	465	7%	0%	992	841	18%
S&D expenses	638	502	27%	9%	1,225	1,009	21%
Other operating charges	589	403	46%	9%	1,127	590	91%
Other Income	125	425	-71%	12%	236	541	-56%
EBITDA	10,351	7,156	45%	10%	19,792	11,184	77%
Financial charges	1,563	1,119	40%	7%	3,022	2,416	25%
PBT	8,023	5,234	53%	11%	15,257	7,206	112%
Taxation	1,926	1,113	73%	19%	3,544	1,554	128%
PAT	6,097	4,121	48%	9%	11,713	5,653	107%
GP Margins	16.9%	16.5%			17.4%	14.3%	
EBITDA Margins	15.7%	16.1%			16.1%	13.9%	
NP Margins	9.2%	9.3%			9.6%	7.0%	

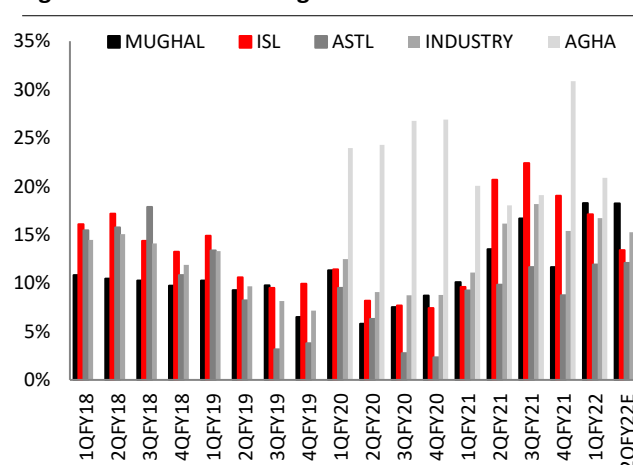
Source: Company accounts, Foundation Research, January 2022

Fig 2: Pricing power to keep gross margins elevated...



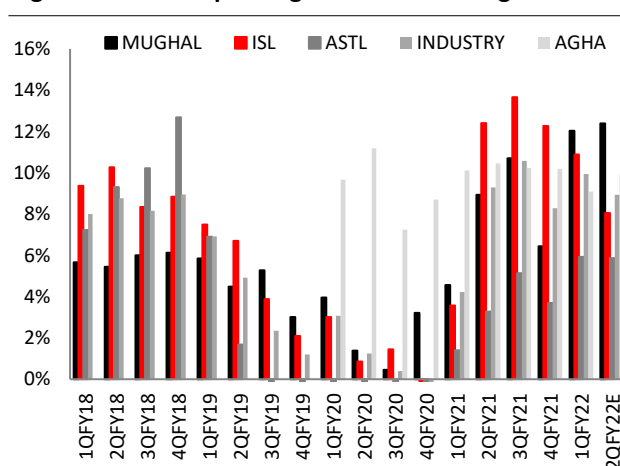
Source: Company acc, FSL Research, January 2022

Fig 3:and EBITDA margins as well



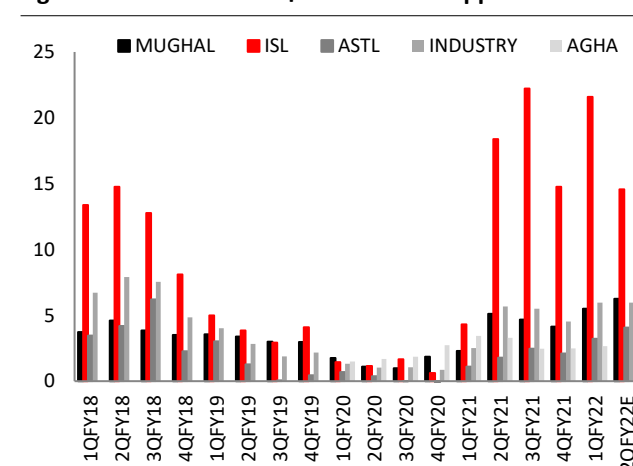
Source: Company acc, FSL Research, January 2022

Fig 4: MUGHAL to post highest ever net margins



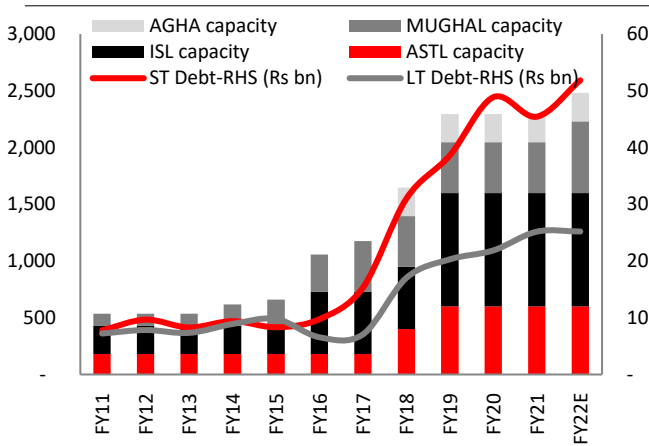
Source: Company acc, FSL Research, January 2022

Fig 5: ISL interest cover ↑ side due to supplier credit



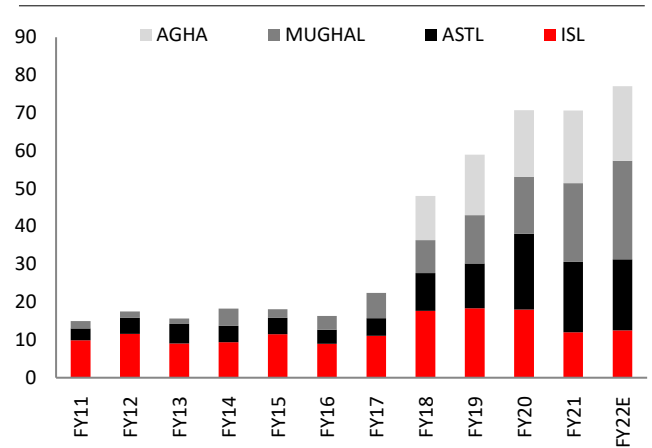
Source: Company acc, FSL Research, January 2022

Fig 6: Debt levels ↑ due to expansions (K tons)



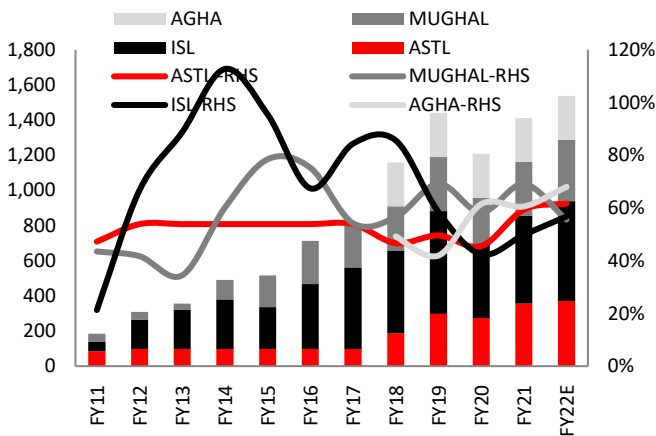
Source: Company acc, FSL Research, January 2022

Fig 7: Debt levels to remain on higher side (Rs bn)



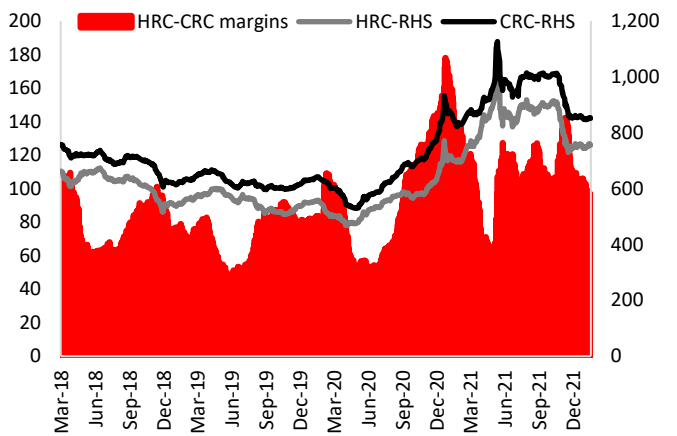
Source: Company acc, FSL Research, January 2022

Fig 8: Strong demand to ↑ production/utilization



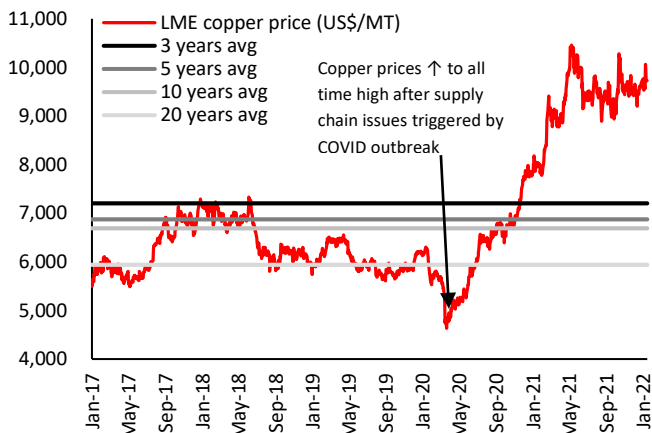
Source: Company acc, FSL Research, January 2022

Fig 9: Pricing power to remain with local players



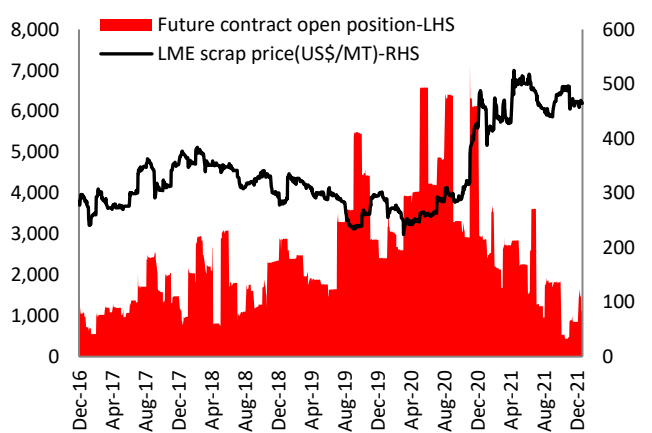
Source: Bloomberg, FSL Research, January 2022

Fig 10: Demand/Supply disparity resulted in ↑ prices



Source: Bloomberg, FSL Research, January 2022

Fig 11: Scrap prices consolidating at current levels



Source: Bloomberg, FSL Research, January 2022

Abbreviations

FY	Fiscal year
EBITDA	Earnings before interest tax depreciation and amortization
ADD	Anti dumping duty
EPS	Earnings per share
HRC	Hot Rolled Coil
CRC	Cold Rolled Coil
LT	Long term
ST	Short Term
PAT	Profit before tax
PBT	Profit after tax
YoY	Year-on-Year
Bn	Billion
Mn	Million
WC	Working Capital

Important disclosures:

Disclaimer: This report has been prepared by FSL. The information and opinions contained herein have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. Such information has not been independently verified and no guaranty, representation or warranty, express or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This document is for information purposes only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as, an offer, or solicitation of an offer, to buy or sell any securities or other financial instruments. FSL may, to the extent permissible by applicable law or regulation, use the above material, conclusions, research or analysis before such material is disseminated to its customers. Not all customers will receive the material at the same time. FSL, their respective directors, officers, representatives, employees, related persons may have a long or short position in any of the securities or other financial instruments mentioned or issuers described herein at any time and may make a purchase and/or sale, or offer to make a purchase and/or sale of any such securities or other financial instruments from time to time in the open market or otherwise, either as principal or agent. FSL may make markets in securities or other financial instruments described in this publication, in securities of issuers described herein or in securities underlying or related to such securities. FSL may have recently underwritten the securities of an issuer mentioned herein. This document may not be reproduced, distributed or published for any purposes.

Research Dissemination Policy: Foundation Securities (Pvt.) Ltd. endeavors to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as mail, fax and/or email. Nevertheless, not all clients may receive the material at the same time.

Target price risk disclosures: Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company will enter into transactions, including transactions in derivative instruments, to manage certain of these exposures.

Analyst certification: The views expressed in this research accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views in this research. The analyst principally responsible for the preparation of this research receives compensation based on overall revenues of Foundation Securities and has taken reasonable care to achieve and maintain independence and objectivity in making any recommendations.

Recommendations definitions

If	
Expected return >+10%	Outperform.
Expected return from -10% to +10%	Neutral.
Expected return <-10%	Underperform.