Amreli Steels—ASTL

ABBASI SECURITIES

REP-091
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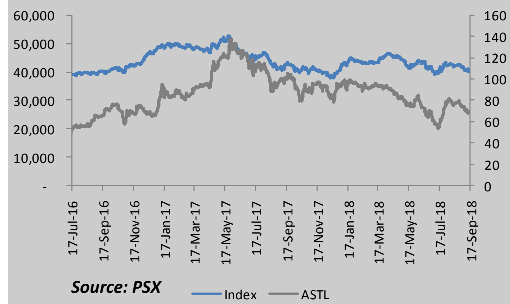
KATS Symbol	**ASTL**
Reuters Symbol	AMST.KA
Target Price	**Rs. 73**
LDCP	Rs. 70
Outstanding Shares (mn)	297.01
Free Float (mn)	74.25
Market Cap (mn Rs)	20,345.28

Price Performance vs KSE100 Index



Source: PSX

EPS Estimates

	FY18	FY19E	FY20E
EPS	5.34	7.6	9.44
P/E	13.11	9.21	7.42
GM	17.80%	15.25%	14.69%
NM	10.23%	8.47%	7.71%

Source: Co Financials, AS Research

FY18 Result Review

ASTL has announced its annual result in which it posted FY18 EPS of Rs5.34, registering a growth of 47.59% YoY against the EPS of Rs3.62 in FY17. Furthermore, the company has also declared a cash dividend of Rs2.2 per share.. The company has posted the revenue of Rs15.5bn in FY18 against Rs13.2bn in FY17, recording a growth of 16.69% YoY. We note that this growth is attributed to increased retail prices of re-bars and volumetric growth on account of robust demand in FY18 due to high construction activities during the election year. Gross margin has slightly squeezed to 17.8% in FY18 as compared to 18.6% in FY17 due to increased international steel scrap prices and rupee devaluation. Finance Cost has increased to Rs476mn in FY18 as compared to Rs251mn in FY17, increased by 89.3%. Increase in finance cost is attributed to the additional debt borrowed for new expansion project of rolling mill in SITE area. Cost of the said project is around Rs2bn which would be financed through 80% debt and 20% equity. Furthermore, increase in discount rate to 7.5% has also contributed in raising the finance cost. Company has booked the tax credit in 4QFY18 on account of new rolling mill at Dhabeji, commenced earlier.

Sector Dynamics

- During last three years, the demand for long products have increased with a CAGR of 14% which encouraged steel producers to expand their production capacities. Currently, the re-bar demand of industry stands at around 4—4.5mn tons which would increased to 5.5—6mn tons by about FY20
- Furthermore, anti-dumping duty of 19.15% on imported re-bars and 24.04% on imported billets for the next five years have put the domestic industry into comfort zone as the anti-dumping duties would allow the local players to utilize their own capacities to cater demand.
- As far as demand is concerned, the upside potential seems to be limited as the inflation is going up which is causing the SBP to contract the economy by raising interest rates. On the other hand, 3 to 4 main players of steel sector including Naveena Steels (Expansion: 300,000 tons p.a.) and Agha Steels (Expansion: 500,000 tons p.a.) are coming up with their additional capacities within 1 to 2 years.

Expansion in ASTL's Production Capacity

- Total production capacity of billets and re-bars stands at 400,000 and 605,000 tons per annum respectively after the commencement of new rolling mill at Dhabeji later in FY18
- Furthermore, two more expansions are also in pipeline at Dhabeji and Site area after which the total production capacity of billets and re-bars would be enhanced to 600,000 and 700,000 tons per annum in FY19 and FY20 respectively

Creating New Market Place in North Region

- We expect the company would target north region besides satisfying south's demand in order to utilize its expanded capacity
- A five year tax break on new rolling mill under section 65E would allow the company to offer discounts in order to gain market share. However, we expect grabbing the market share from well established and low cost re-bar producers wouldn't be an easy task for ASTL in north region
- Selling the re-bars in north region would help the company in achieving volumetric growth but there are some downsides of this strategy as well. Firstly, the company would have to bear an additional transportation cost of Rs2,500—Rs3,000 per ton. Secondly, the company would have to compete with a number of low cost re-bar producers in north by selling its re-bars on discounted prices as compared to the prices it is offering in south region

Key Demand Drivers

- ASTL is already qualified for providing re-bars for the construction of Dasu Dam which is expected to generate an additional demand of 8,000—10,000 tons per month for the next eight years. Sukki Kinari is also expected to generate an additional demand of 5,000 tons per month for the next 4 years. Furthermore, Diamer Bhasha Dam is a reservoir based dam which will also generate an additional demand of around 20,000 tons per month for the next ten years. If ASTL would get succeeded in winning the bids of Sukki Kinari and Diamer Bhasha dams then the company could easily achieve 100% utilization level
- The newly formed government of PTI has already announced the construction of 5mn low cost small houses in order to provide shelter to the underprivileged section of the society. In this regard, if we assume that the size of the house would be of 80 square yards, then the housing project will generate an additional steel demand of around 150,000 tons per month. However, the materialization of this project is challenging as huge funds are required for the execution of this project

Expected Withdrawal of Subsidy and Increase in Electricity Tariff

- Government is considering to cut the subsidy of Rs3 on electricity tariff and to increase the tariff by Rs2. Materialization of this decision will further increase the cost of ASTL by about Rs4,000 per ton. Therefore, we have a cautious stance on the sector with respect to its demand & supply imbalance and upcoming expected decisions of increasing electricity tariffs

Valuation

ASTL is currently trading at FY19E PE of 9.21x. Assuming re-bar sales volume around 260,000 tons in FY19, we have a hold stance on ASTL with a target price of Rs73 (June-19) and offers dividend yield of 4.2%.

Key Risks

Delay in the projects mentioned above, supply glut due to large capacity expansions, increase in international scrap prices, recommencement of Pakistan Steel Mill

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Valuation Methodology

To arrive at period end target price, Abbasi Securities uses different valuation methodologies:

- Comparable Method (P/E, P/B, Justified P/B & P/E etc.)
- Discounted Cash flow Method
- Equity and Asset based valuation

Rating

BUY	Total return more than 20% from last closing of market price
HOLD	Total return is in between 10% and 20% from last closing of market price
REDUCE	Total return is less than 10% from last closing market price

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