

We initiate our coverage on ISL with BUY stance and DCF based target price of Rs133/- (Dec-18), providing 24% upside and a dividend yield of around 4.4%. ISL is currently trading at FY18E and FY19E P/E of 11.2x and 8.9x respectively. Our liking of the stock is based on:

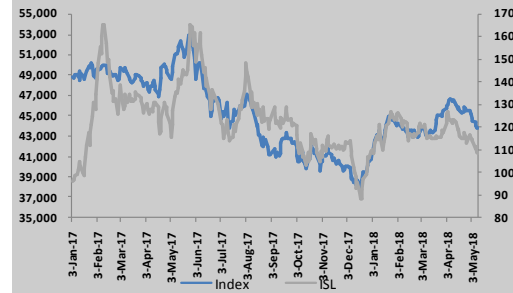
1. Capacity expansion of CRC (Cold Rolled Coil) to meet growing local demand and capture market share of Importers. Furthermore this will also allow them to produce more HDGC (Hot Dip Galvanized Coil) on which ISL earns a higher margin
2. Imposition of ADD (Anti Dumping Duty) by NTC (National Tariff Commission) on flat steel which provide a relief to the local industry whereas local prices are still 18 to 20 percent lower than the imported landed price of CRC from China

Well-timed expansion would play a vital role in enhancing ISL’s market share and will also provide import substitution

- Flat steel demand in Pakistan is around ~1.3mntpa, and growing at ~12% per annum which is emanate from improved economic activities and as a result home appliances and auto sector volumes (major portion of auto sales comes from motor bikes) grew at a CGAR of 5.3% and 8.6% respectively (as shown in figure 1 & 2), going forward we expect this trend is likely continue and will absorb additional flat steel capacity as well as grab importer market share (i.e. ~36%)
- ISL and ASL both has a capacity to produce ~64% of the country flat steel demand, while rest of demand is currently being met through imports
- To fulfill the gap in local markets ISL is expanding CRC capacity from 550ktpa to 1,000ktpa, with a CAPEX ~Rs5.6bn which is financed by 25% from own cash generation, while remaining through debt. Moreover work on another line of CRC ~100ktpa is also on card
- ISL is all set to commission its new capacity in Jun-18. This will remove the bottleneck to produce higher margin products (i.e HDGC) which remain under utilized due to limited CRC capacity, that will provide room to capture market share further. (ASL expansion is expected to commence operations by April-19)
- ISL is further diversifying its operations through vertical integration by launching two Product Service Centers in Karachi and Lahore which is expected to add Rs0.31/share from FY20 onwards

KATS Symbol	ISL
Reuters Symbol	INTE.KA
Target Price	Rs133
LDCP	Rs106.92
Outstanding Shares (mn)	435
Free Float (mn)	174
Market Cap (mn Rs)	46,510

Price Performance Against KSE100 Index



Source: PSX

	ISL Earning Estimates			
	FY17A	FY18E	FY19E	FY20E
EPS	7.00	9.63	11.92	14.49
Gross Margin (%)	17.51%	16.50%	13.88%	13.11%
Capacity - CRC (MT)	550,000	550,000	1,000,000	1,100,000
Utilization	84.37%	85.25%	62.65%	69.90%
Capacity - HDGC (MT)	462,000	462,000	462,000	462,000
Utilization (%)	67.72%	68.43%	97.64%	100%

Source: ASL Research

Fig.1 Home Appliances Production (000)

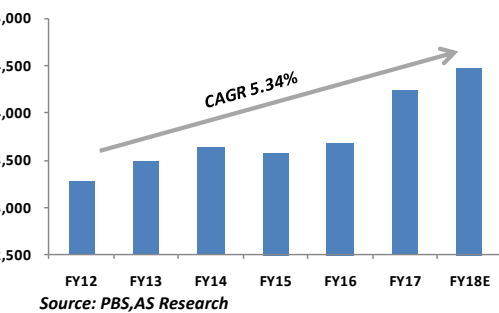
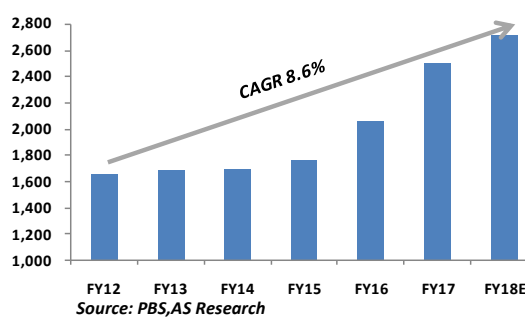


Fig.2 Motorcycle Production (000)



Duties will continue to provide buffer from international prices

- We believe upcoming massive expansion is backed by robust Flat steel demand along with better import cover through duties
- Whereas NTC has imposed Anti dumping duty (ADD) on CRC from China and Ukraine 19.02%/18.92% effective from Jan-16 and ADD on HDGC ranging from 6%-40% effective Feb-17 for a period of five years
- However local CRC importers were awarded stay order against ADD subject to provision of 100% bank guarantee to the equivalent amount of ADD on imports.
- We noted that local manufacturers are not utilizing full benefit of prevailing duty structure. We estimate that local CRC prices are ~18%-22% below from landed CRC prices

Research Department
021-111-555-275
research@abbasisecurities.com

USA imposed tariff on Chinese steel Imports

- USA total steel imports stands ~34.6mnt and China's share is only 2% which comes ~0.692mnt (i.e. 0.94% of total Chinese exports)
- In the meantime USA has imposed tariff of ~25% on 1,333 products including steels on imports from china
- We believe this will not have any significant impact on Pakistan's flat steel producers of further dumping of CRC and HDGC in to Pakistan as NTC has already provide cover by imposing ADD

Gross margins are likely to normalize going forward

- ISL reported a gross margin of ~15.8% in 3QFY18. We expect margins to adjust downwards as competition increases in local market once ASL expansion come online
- We have incorporated average gross margins of ~13.5% in our model. We believe that current margins (i.e. 9MFY18 average gross margins are 16.59%) are cyclically on a higher side and will normalize going forward
- We estimate that every \$5/ton decline in primary spread between HRC and CRC, earnings is estimated to decline by 9%-10%

Valuation

ISL is currently trading at FY18E and FY19E P/E of 11.2x and 8.9x respectively. We have a BUY stance with DCF based target price of Rs133/- (Dec-18), providing 24% upside from LDGP and a dividend yield of around 4.4%.

Key risk to our estimate

- Delay in expansion
- PKR devaluation
- Adverse change in duty structure and HRC/CRC core margin
- Unfavorable outcome of case pending in High Court

Disclaimer

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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 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