



International Steel (ISL)

Earnings revised downward, 'BUY' maintained

Shankar Talreja^{AC}
shankar@topline.com.pk
Tel: +9221-35303330
Topline Securities, Pakistan

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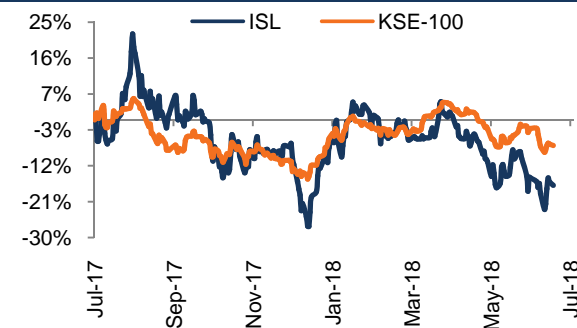
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Earnings revised downward ‘BUY’ maintained

- We have revised down our earnings forecast for International Steels (ISL) by 2%, 23% and 34% to Rs9.3, Rs13.1, and Rs13.5 per share for FY18, FY19, and FY20 respectively, amid 1) rising flat steel products prices; up by ~25% since FY17 resulting in lower volumetric growth going forward, 2) threat of oversupply that will contain margins after recently commenced new line of International Steels (ISL) and upcoming expansions of Aisha Steel (ASL) and Siddiqsons tinplate (STPL), and 3) expectations of slowdown in economy. Based on aforementioned factors we believe, sustainability of historical 3-year (FY16-18) demand CAGR of 12% is unlikely. We believe, demand for flat steel products during FY19-23 will grow at CAGR of 6%. However, we maintain our ‘BUY’ recommendation on ISL based on Jun 2019 target price (TP) of Rs111, offering total return of Rs23% (including dividend yield of 5%).
- Domestic flat steel product prices have surged around 25% in last one year due to imposition of Anti Dumping Duties (ADD) from time to time and to pass on impact of 1) currency devaluation, and 2) increase in Hot Rolled Coil (HRC) prices. Currently, flat steel products prices are ranging from Rs108k to 130k (inclusive of sales tax) vs. 86k to 105k a year ago. We believe, due to rising steel prices, historical 3-year (FY16-18) CAGR of 12% will not be sustainable going forward amid weakening of economy where we expect GDP growth at 4.7% for FY19 compared to 5.8% last fiscal year.

KATS Code	ISL
Bloomberg Code	ISL PA
Reuters Code	INTE.KA
Market Price	Rs94.27
Market Cap	Rs41.0bn/US\$337.5mn
Free float Market Cap	Rs16.4bn/US\$135.0mn
1-Yr Avg. Daily Vol. (mn)	2.3
1-Yr Avg. Daily Val. (mn)	Rs276.4/US\$2.5
1-Yr High/ Low	Rs148.3/88.3
Estimated free float	40%
Share outstanding (mn)	435.00
Index weight	0.83%

ISL vs KSE-100 Index



Source: PSX, Topline Research

Capacity surplus of 28% expected in FY20

- ISL has successfully commenced operations of its new line, taking its overall capacity to 1mn tons (nearly equal to demand of Pakistan as of FY17). On the other hand ASL and STPL are also coming up with their new capacities of ~480k tons and 200k tons in 4QFY19 and 4QFY20 respectively. With this Pakistan's total capacity by FY20 will reach to 1.9mn tons against projected demand of 1.36mn tons and 1.45mn tons in FY20 and FY21 respectively, leaving surplus capacity of 28% and 31% in FY20 and FY21 respectively, vs. current demand supply deficit of 37% in FY18E. Higher surplus capacity could lead to lower flat steel growth of 6% vs. historical 3-year (FY16-18) CAGR of 12%.
- Continuation of imports from China, Russia, U.S.A., Canada and European countries is another risk to optimal utilization of local industry post commencement of new plants. To investigate this matter further, we visited Karachi's main flat steel market, where we witnessed imported flat steel available from above mentioned countries in prime as well as secondary form. Secondary coils are procured at discounted rate of around US\$500-550 per ton (mainly from European countries) as against primary coil rates of US\$600-640 per ton.
- Moreover, prices of Chinese coils were nearly equal to ISL's prices, while prices of coils from other countries varies on shipment and quality basis, despite the anti dumping duties imposed on china ranging from 6-40%. Incorporating this situation we expect imports to continue going forward, resulting into lower utilization of local players in F20/21.

Lower economic growth to impact volumes and margins both



- CRC-HRC spread is currently below US\$70 per ton vs. Last 5 years average of US\$110 per ton. Lower spread is mainly due to increase in HRC prices faster than CRC amidst its tightened supply and higher demand, that is likely to be restored to its normal level as reported by industry publications. We expect spread to average at US\$80 per ton during FY19-21 (against 5-years average of US\$110) due to slowdown in global economy where World Bank (WB) forecast suggest world GDP to fall at 3.0% and 2.9% during FY19 and FY20 respectively, against 3.1% in FY18 which may cause utilization of international players to clock in at lower side. Moreover, we present our sensitivity analysis on ISL's earnings based on variable margins.

Sensitivity Analysis									
	FY19				FY20				
Spread (US\$ Per tons)	70	80*	100	120	70	80*	100	120	
EPS	11	13	17	21	12	14	18	22	

Source: Topline Research

*Base case

- Due to expected increase in gas prices & lower CRC-HRC spread, ISL's gross margins is expected to decline to 14.6% and 13.7% during FY19 and FY20 respectively from expected average of 16.55% during FY18, as we opine ISL will partially be able to pass on local cost pushing factors like increase in gas price etc.

Upside Triggers, Valuation, and Key risks

- Amid oversupply supply situation, there is a likelihood that local companies might opt for exports, as STPL has already signaled possibility of export in Middle east and other Asian countries. Our discussion with the industry suggest that, exports to middle east from Pakistan will have an added advantage in terms of lead time, as local manufacturers can export in time period of 15 days compared to Chinese lead time of minimum 45 days; this can also lend premium pricing to local players. Despite this, fate of exports will be decided on spread of CRC-HRC. We believe, exports won't be feasible at current level spread of US\$65 per ton. We haven't assumed exports in our valuation/earnings forecast.
- We maintain our 'BUY' stance on ISL based on its Jun 2019 Target Price (TP) of Rs111 offering total return of 23% (including dividend yield of 5%). This stock has shed around 43% from its high of Rs165 as of May 26, 2017 and has underperformed market by 20% from its peak.
- Key risks to valuation/earnings include: 1) higher than expected increase in gas prices, 2) lower CRC-HRC spread, 3) Dumping of steel from other countries, 4) disrupted gas supply, and 5) lower utilization level.

ISL: Key Numbers					
	FY16	FY17	FY18E	FY19F	FY20F
EPS	2.7	7.0	9.3	13.1	13.5
Earnings Growth	484%	158%	33%	41%	3%
PE at Rs94.27	34.8	13.5	10.1	7.2	7.0
Dividend Yield	1%	1%	4%	6%	6%
ROE	19%	40%	40%	42%	35%
PBV	6.6	5.4	4.1	3.0	2.4

Source: Company Accounts, Topline Research

International Steels Limited (ISL) – Financial Highlights



Income Statement

Rsmn	FY16	FY17	FY18E	FY19F	FY20F
Net Sales	20,492	33,733	46,716	74,677	76,170
Gross Profit	2,906	5,906	7,732	10,903	10,470
Admin Expense	161	215	409	653	666
Selling and distribution expenses	207	334	53	56	59
Finance Cost	732	456	563	1,526	1,187
Profit before tax	1,654	4,609	6,050	8,037	8,153
Profit After Tax	1,179	3,044	4,054	5,706	5,870
EPS (Rs)	2.7	7.0	9.3	13.1	13.5

Source: Company Accounts, Topline Research

Balance Sheet

Rsmn	FY16	FY17	FY18E	FY19F	FY20F
Non-Current Assets	12,620	13,643	17,788	17,610	17,434
Current Assets	8,364	12,728	19,295	29,647	28,627
Total Assets	20,984	26,371	37,083	47,257	46,061
Equity	7,143	8,554	10,976	14,399	17,921
Non-Current Liabilities	4,880	5,101	8,786	7,936	7,103
Current Liabilities	8,961	12,716	17,322	24,922	21,037
Total Equity & Liabilities	20,984	26,371	37,083	47,257	46,061

Source: Company Accounts, Topline Research

Assumptions

	FY16	FY17	FY18E	FY19F	FY20F
Assumptions					
Utilization level	67%	84%	98%	75%	75%
PKR-USD	104	105	121	131	140
Industry Capacity (000's tons)	770	770	770	1,340	1,750
Industry Sales (000's tons)	1,175	1,100	1,214	1,286	1,364

Key Ratios

	FY16	FY17	FY18E	FY19F	FY20F
Earnings Growth	484%	158%	33%	41%	3%
PE at 94.3	34.8	13.5	10.1	7.2	7.0
Dividend Yield	1%	1%	4%	6%	6%
PBV	6.6	5.4	4.1	3.0	2.4
Gross Margin	14%	18%	17%	15%	14%
Net Margin	6%	9%	9%	8%	8%
Pre Tax Margin	8%	14%	13%	11%	11%
ROA	6%	12%	11%	12%	13%
ROE	19%	40%	40%	42%	35%
Current Ratio	0.9	1.0	1.1	1.2	1.4
Tax Burden	71%	66%	67%	71%	72%
Financial Leverage	2.94	3.08	3.38	3.28	2.57

Source: Company Accounts, Topline Research

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Neutral	Stock will perform in line with the average total return of stocks in universe
Sell	Stock will underperform the average total return of stocks in universe

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Over Weight	> Weight in KSE-100 Index
Market Weight	= Weight in KSE-100 Index
Under Weight	< Weight in KSE-100 Index

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