Company Report

Friday, August 2, 2024

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COMPANY UPDATE

International Steels Limited (ISL)				
Engineering				
Recommendation				**BUY**
Target Price: Dec-24				116.0
Last Closing: 1-Aug-24				81.8
Upside (%):				42%
Valuation Methodology:				DCF
Market Data				
Bloomberg Tkr.				ISL PA
Shares (mn)				435
Free Float Shares (mn)				152.25
Free Float Shares (%)				35%
Market Cap (PKRbn)				36.018
Market Cap (USDmn)				129.3
Exchange				KSE-100
Price info.	**01M**	**03M**	**09M**	**12M**
Abs. Return	1%	25%	48%	75%
Low	80	66	55	42
High	91	91	91	91
Key Company Financials				
Period End: Jun				
PKRbn	**FY23A**	**FY24E**	**FY25F**	**FY26F**
Total Revenue	76.75	75.31	95.44	116.90
Net Income	3,519	4,084	5,504	6,995
EPS (PKR)	8.1	9.4	12.7	16.1
DPS (PKR)	3.3	5.0	6.0	8.0
Total Assets	42.39	54.08	58.40	62.63
Total Equity	21.68	24.35	28.23	33.05
Key Financial Ratios				
ROE (%)	16%	18%	21%	23%
P/E (x)	10.3x	8.9x	6.6x	5.2x
P/B (x)	1.7x	1.5x	1.29x	1.10x
DY (%)	4%	6%	7%	10%

Source: Bloomberg, CapitalStake, PSX, Company Financials, IGI Research

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Engineering

ISL: Improved Demand Dynamics and Cheaper Valuations Warrant "BUY" Stance

- We recommend ISL with a 'BUY' rating and target price of PKR 116/share offering 42% upside from last close. The Company is in the business of manufacturing cold rolled, galvanized and color coated steel coils and sheets.
- We base our investment thesis on a) Increase in appliances demand and agriculture yields, b) Positive demand outlook for 2/3 wheeler segment, c) Higher HRC-CRC margins to keep profitability afloat, d) Efficient operating cycle and strategic debt reduction and f) Investment in associate for accommodation camp at Reqo-Diq Mine.
- We estimate ISL earnings for next 5 years to post 20.5% CAGR reaching PKR 8.6bn compared to the last reported earnings of PKR 3.5bn.
- Using DCF, we have a 'BUY' rating on ISL with a Dec-24 target price of PKR 116/share offering ~42% upside from the last closing price of PKR 81.8/share. The Company trades at FY25/26 P/E of 6.6/5.2 with 6% dividend yield.

Reiterating our "BUY" rating on International Steels Limited (ISL) with "BUY" Rating

We recommend ISL with a 'BUY' rating and target price of PKR 116/share offering 42% upside from last close. The Company is in the business of manufacture and sale of flat steel products that include cold rolled, galvanized, and color coated steel coils and sheets.

We base our investment thesis on a) Increase in appliances demand and agriculture yields, b) Positive demand outlook for 2/3 wheeler segment, c) higher HRC-CRC margins to keep profitability afloat, d) efficient operating cycle and strategic debt reduction and f) Investment in associate for accommodation camp at Reqo-Diq Mine.

Recommendation: We have a 'BUY' rating on ISL with a Dec-24 target price of PKR 116/share offering a ~42% upside from the last closing price of PKR 81.8/share (1-Aug-24). The Company is currently trading at FY25/26 P/E of 6.6/5.2 and offers a dividend yield of 7%.

Key Catalyst: Key catalyst include a) interest rate decline, b) High HRC-CRC margins likely to improve profitability, c) higher than expected increase in 2/3 wheeler demand, d) Better agricultural yields.

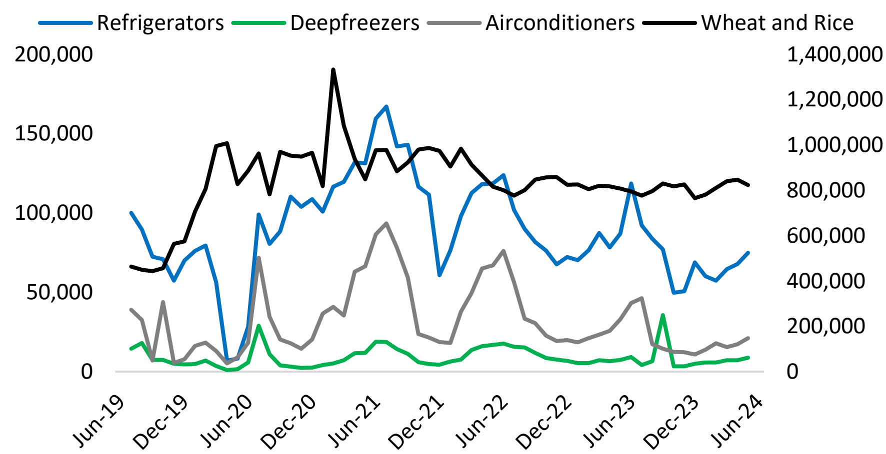
Key Risk: Key risk include a) Lower CRC-HRC spreads and, b) Excessive dumping from FATA/PATA.

Investment Thesis

1. Increase in Appliances demand and agricultural yields

Flat steel products manufactured by ISL are used by the appliances manufacturers and are also used for storage silos in the agriculture sector. Appliance industry contributes to ~18% and agriculture sector contributes to ~12% of of the total ISL sales, we expect an increase in the appliance demand owing to improvement in the purchasing power. The appliance demand has witnessed a significant improvement since 2HFY24, and the demand is expected to further improve on the back of LC restrictions being ended. On the other hand the agriculture sector witnessed a growth of 6.3% in FY24 and the yields are expected to further increase during FY25 due to the increased focus of SIFC on the sector by attracting foreign investments.

Exhibit: Production of electrical appliances and agricultural commodities



Source: PBS - QIM, IGI Research

2. Positive outlook on 2/3 wheeler demand

As per our analysis 2/3 wheeler industry contributes to approximately 54% of the overall ISL's sale. The 3-wheeler sales in FY24 increased by 28%y/y whereas the 2-wheeler sales augmented by -4%y/y. Looking forward; we expect the 2/3 wheeler demand to stay positive owing to the lower inflation outlook and monetary easing cycle that has just begin leading to increased availability of consumer financing.

Exhibit: Capacity and Utilization (RHS)

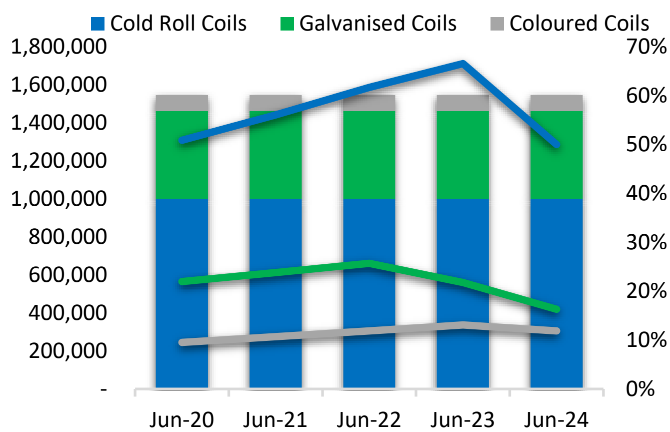
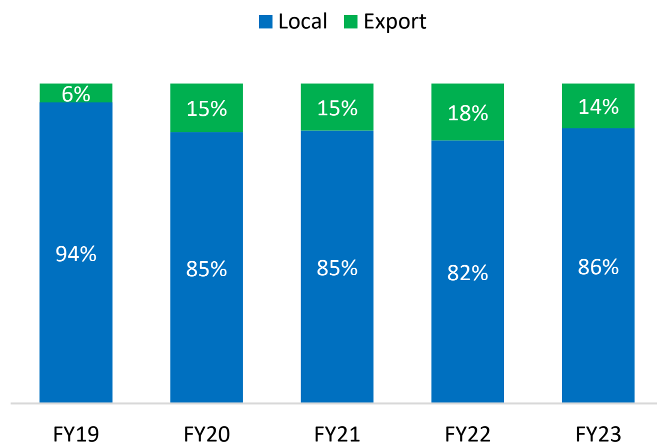


Exhibit: Export and Local Sales Break-up

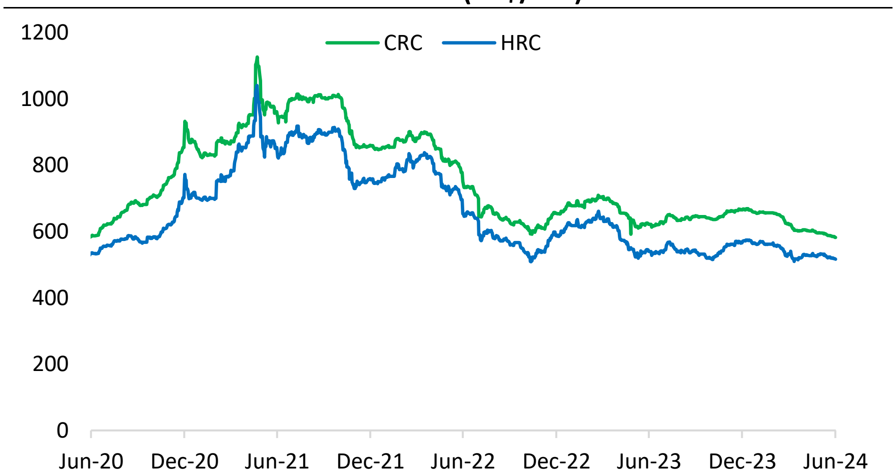


Source: Company Accounts, IGI Research

3. Higher HRC-CRC margins to keep profitability afloat

Average HRC price during 2HFY24 stood at US$ 568/ton. The HRC prices have been favorable since last couple of years. The average prices during FY24, FY23, FY22 and FY21 stood at US$ 540/ton, US$ 570/ton, US$ 671/ton and US$ 825/ton respectively. The gross margins of ISL are primarily based on the CRC-HRC spread, the CRC-HRC spread stood at USD 85/ton during in FY23. We have incorporated the spread at USD 56/ton for FY24 and USD 65/ton for FY25 for our analysis which is in line with the historical averages and a stable future outlook for CRC and HRC prices. The HRC and CRC prices witnessed a hike during FY20 and FY21 owing to weak demand from key industries and supply chain disruptions across the globe due to COVID-19.

PABC: Historical HRC and CRC Prices (US$/ton)



Source: Bloomberg, IGI Research

4. Efficient operating cycle and strategic debt reduction

ISL has been managing the cash conversion cycle very efficiently since last few years by dragging the payable days from 50 days in FY21 to approximately 78 days during FY24. The cash conversion cycle of ISL during FY24 would be around 39 days compared with 59 days during FY21. This efficient management of inventories, receivables, and payables has significantly improved cash position of the Company. ISL has been successful in reducing its long-term debt from PKR 3.73bn in FY21 to PKR 0.77bn in FY24. This reduction in debt levels is attributable to efficient inventory management as ISL's inventory has come down to PKR 18.15bn as at Mar-24 from PKR 30.2bn as at Jun-22. We expect further the cash position to remain strong going forward owing to improved cash cycle. This should enable ISL to improve cash payouts going forward.

Exhibit: Working Capital and Cash position (PKRmn)

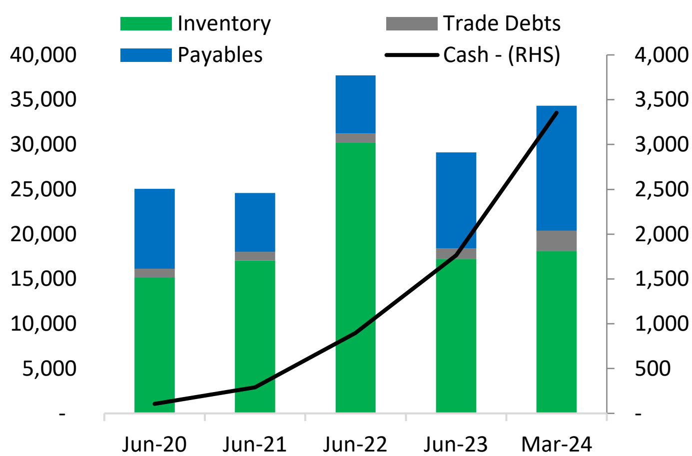
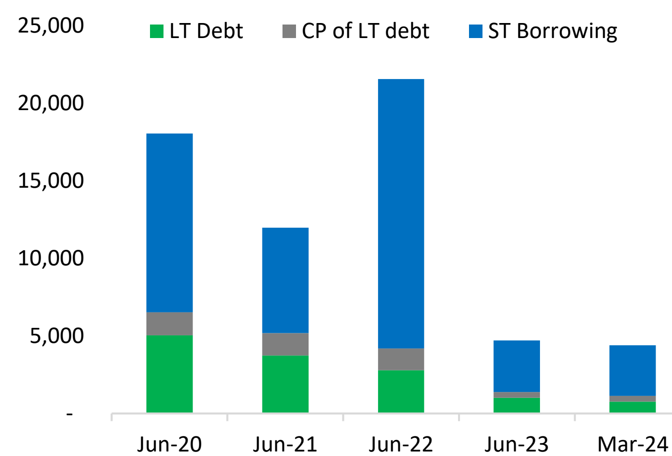


Exhibit: Debt position (PKRmn)



Source: Company Accounts, IGI Research

5. Investment in Associate for Accommodation camp

ISL has been invited for an equity investment in the design and construction of a permanent accommodation camp at RekoDiq Mines by the Chinoy Engineering & Construction (Pvt) Limited (CECL), an associated company to invest PKR 48.45mn which is 17% of its post-issuance paid-up capital.

6. Earnings to grow at 5yr CAGR of 20.5%

We expect earnings to grow at a 5 year CAGR of 20.5% on the back of positive demand outlook, lower debt levels, improving cash positions and stable margins from HRC-CRC.

Recommendation: We have a 'BUY' rating on ISL with a Dec-24 target price of PKR 116/share offering a ~42% upside from the last closing price of PKR 81.8/share (1-Aug-24). The Company is currently trading at FY25/26 P/E of 6.6/5.2 offering a dividend yield of 7%.

Trading at significant discount to historic P/E

The company is currently trading at 2025F P/E of 6.6x significantly discounted to historic average of 10.50x.

Exhibit: Relative Price Performance

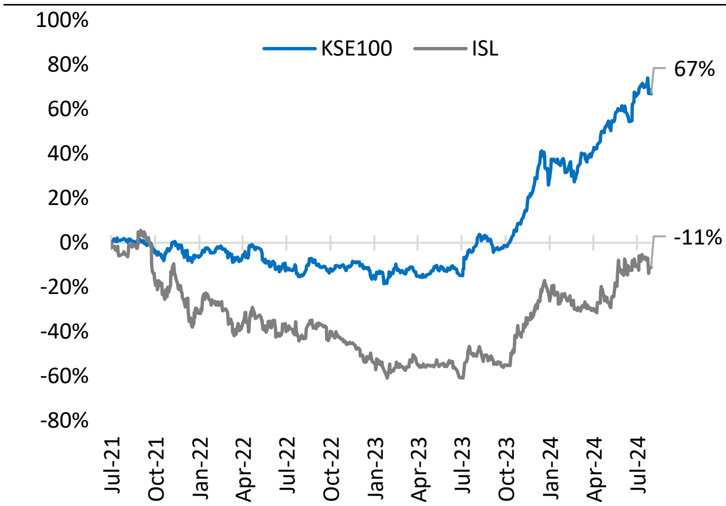
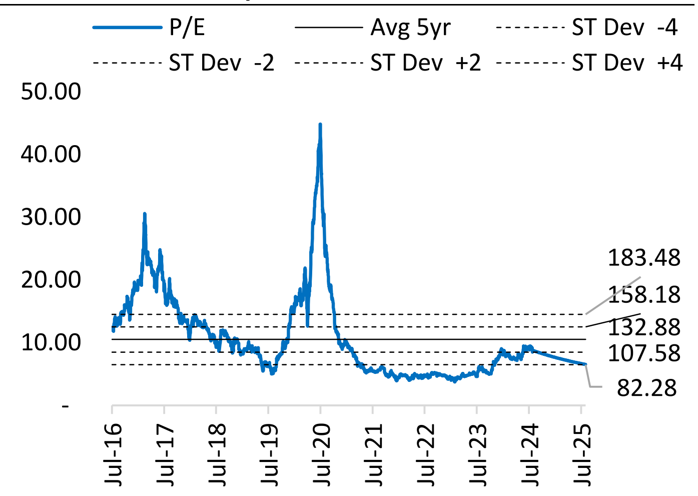


Exhibit: Historical P/E & Standard Deviation



Source: PSX, Company Accounts, IGI Research

Key Catalyst

1. **Interest Rates:** Higher than expected decline in interest rates is likely boost demand further and reduce finance cost even further.
2. **Higher than expected increase in 2/3 wheeler demand:** Higher than anticipated demand of 2/3 wheeler would translate in to improved earnings.
3. **Improving agricultual yields:** Flat steel products are used in manufacturing of storage silos for agricultural commodities, given the 6.3% growth in agriculture sector in FY24 and the increasing focus of SIFC to attract foreign investment in the sector we are positive about the future outlook of the sector in the short-to-medium term, which would result in an increase in ISL's sales.

Risk to Rating

1. **Lower HRC-CRC spread:** Lower HRC-CRC spreads will reduce margins and lead to decline to profitability.
2. **Dumping from FATA/PATA:** The FATA/PATA region is still exempt from Sales Tax on steel products which makes the ISL products relatively expensive compared to the products from FATA/PATA region.

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Financial Summary

International Steel Limited (ISL)

Current Price (PKR): 82 | **Target Price (PKR): 116** | **Upside: 42%** | **Recommendation: BUY**

PKRmn	FY20A	FY21A	FY22A	FY23A	FY24E	FY25E	FY26E
Income Statement							
Net Sales	48,082	69,796	91,424	76,753	75,314	95,448	116,903
Gross Profit	4,213	13,492	12,381	10,608	9,279	11,790	14,066
Operating Profit	3,056	12,067	10,430	9,221	7,085	9,292	11,261
EBIT	2,757	11,107	9,323	7,456	6,337	8,404	10,225
EBITDA	4,149	12,626	10,821	9,132	9,447	12,560	14,430
Finance Costs	2,315	812	1,323	2,264	966	1,166	1,026
Profit Before Tax	442	10,295	8,001	5,191	5,371	7,238	9,199
Taxation	(53)	2,828	2,589	1,673	1,287	1,734	2,204
Profit After Tax	495	7,466	5,412	3,519	4,084	5,504	6,995
Balance Sheet							
Inventory	15,132	17,081	30,197	17,262	19,545	23,349	27,019
Receivables	1,016	940	1,034	1,148	1,814	2,070	2,315
Current Assets	22,172	22,520	34,915	21,733	34,649	39,187	43,650
PP&E	20,638	19,180	20,750	20,305	19,073	18,856	18,623
Total Assets	42,861	41,720	55,905	42,392	44,076	50,397	55,626
Payables	8,921	6,588	6,470	10,713	17,459	19,706	21,875
Current Liabilities	23,556	16,357	29,213	17,407	27,882	29,070	28,971
LT Loans	5,042	3,731	2,779	1,006	540	297	55
Total Liabilities	30,135	22,832	34,309	20,708	29,722	30,170	29,580
Paid Up Capital	4,350	4,350	4,350	4,350	4,350	4,350	4,350
Total Equity	12,726	18,888	21,596	21,684	24,354	28,226	33,046

	FY20A	FY21A	FY22A	FY23A	FY24E	FY25E	FY26E
Per Share							
EPS	1.1	17.2	12.4	8.1	9.4	12.7	16.1
DPS	0.5	6.8	5.0	3.3	5.0	6.0	8.0
BVPS	29.3	43.4	49.6	49.8	56.0	64.9	76.0
Growth rates & Margins							
Sales Gr. %	-16%	45%	31%	-16%	40%	14%	12%
EPS Gr. %	-81%	1409%	-28%	-35%	16%	35%	27%
Gross Margin	9%	19%	14%	14%	12%	12%	13%
EBIT Margin	6%	16%	10%	10%	6%	7%	7%
Net Margin	1%	11%	6%	5%	4%	4%	5%
Valuation							
P/E	73.4x	4.9x	6.7x	10.3x	8.9x	6.6x	5.2x
DY	1%	8%	6%	4%	4%	6%	8%
P/B	2.9x	1.9x	1.7x	1.7x	1.5x	1.29x	1.10x
Op. Cf Yld	0%	2%	3%	6%	25%	13%	17%
ROE	4%	47%	27%	16%	18%	21%	23%
ROA	1%	18%	11%	7%	8%	10%	12%
P/EBITDA	8.8x	2.9x	3.4x	4.0x	4.9x	3.8x	3.2x
EV/EBITDA	13.1x	3.8x	5.3x	4.3x	5.8x	4.3x	3.4x
Volumetric Sales (mn cans)							
Capacity Utilisation	46%	51%	55%	54%	40%	43%	45%
Sales	463	506	552	536	404	427	452

Source: PSX, Capital Stake, Company Accounts, Bloomberg, IGI Research

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