

PAKISTAN STEEL

MARKET VISTA

REP-019

Metal prices dip as the energy crunch intensifies

- International scrap/copper prices have decreased by 3.5%/1%MoM in Sep'21 to currently hover around US\$483/9289/ton compared to last 3 months avg. of US\$493/9407/ton as global demand relaxes with economic activity halting on the back of enormous shortage of electricity in world's leading manufacturing nations amid floods, other weather disruptions and Evergrande fallout
- Furthermore, partial closure of steel and metal manufacturing facilities are on the cards with looming power/energy shortage (in EU and China) could force countries to shut down or cut production of energy intensive industries. We have incorporated average scrap prices of US\$435/375/ton for FY22/23 against US\$360/ton average for FY21 and copper prices of US\$9000/8700/ton for FY22/23 against US\$7500/ton average for FY21.
- Local rebar prices have remained flat in the month of Sep'21 to stand at 179-180K/tons, following 14%MoM increase in Aug'21.
- In light of economic uncertainty and geopolitical tension, the Steel sector has underperformed (CYTD: -6.1%, FYTD: -11.9%) compared to KSE- 100 benchmark (CYTD: +1.6%, FYTD: -6.1%), however, we expect earnings to remain robust in the near term.
- Our preferred play is ASTL (TP: PkR64/sh, 70% upside) and MUGHAL (TP: PkR179/sh, 83% upside) with stocks currently trading at FY22 P/E of 6.24x/4.38x while on PEG basis, ASTL and MUGHAL is trading at 0.33x/0.16x.

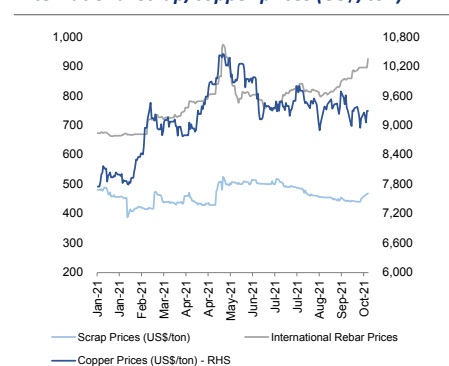
International scrap prices down 3.5%MoM in Sep'21: International scrap/copper prices have decreased by 3.5%/1%MoM in Sep'21 to currently hover around US\$483/9289/ton compared to last 3 months avg. of US\$493/9407/ton as global demand relaxes with economic activity halting on the back of enormous shortage of electricity in world's leading manufacturing nations amid floods, other weather disruptions and Evergrande fallout. Conversely, International aluminum prices have increased by 9.8%MoM in Sep'21 to currently stand at US\$2961/ton compared to last 3 months avg. of US\$2641/ton. Furthermore, partial closure of steel and metal manufacturing facilities are on the cards with looming power/energy shortage (in EU and China) could force countries to shut down or cut production of energy intensive industries. Moving forward, current energy crunch could hurt end product metal supply chain (International rebar prices up 5% MoM in Sep'21) and potentially results in an ease off in commodity prices in the coming months (assuming demand for raw materials slows in major steel producing countries). To note, we have incorporated average scrap prices of US\$435/375/ton for FY22/23 against US\$360/ton average for FY21 and copper prices of US\$9000/8700/ton for FY22/23 against US\$7500/ton average for FY21.

Local rebar prices remained flat MoM in Sep'21: Local rebar prices have remained flat in the month of Sep'21 to stand at 179-180K/tons, following 14%MoM increase in Aug'21 due to higher freight cost (+US\$40-50/ton to US\$80-100/ton vs historical avg. of US\$30-40/ton), PkR devaluation (3.9% since Aug'21) and higher electricity cost. Moreover, the news concerning slashing duties on scrap is gaining momentum but Govt. is yet to confirm or give any clarity on it. However, we believe any benefit associated with the removal of duties will be pass on, resulting in the reduction of local rebar prices. Currently, 5%/2% regulatory/additional custom duty are imposed on imported scrap.

MUGHAL (Non-ferrous) segment to benefit from PkR depreciation: Rising copper prices and PkR depreciation have positive ramifications for MUGHAL as it ventured into the exports of copper ingots by establishing a non-ferrous segment. MUGHAL's raw material composition comprises of compressor/motor electric scrap where the yield, however, varies across different types of scrap. In our estimates, we have assumed a yield of 8% for copper extraction in a ratio of 12.5:1 and expect sales of non-ferrous segment to register a 3yr CAGR of 24% between FY21-24F with an earnings contribution of 44% in FY22.

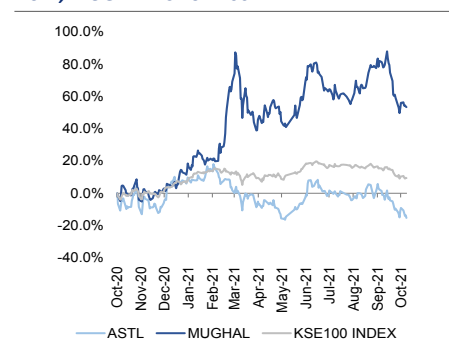
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International scrap/copper prices (US\$/ton)



Source: Bloomberg & AKD Research

ASTL, MUGHAL vs KSE-100 INDEX



Source: PSX & AKD Research



AKD Securities Limited

Investment Perspective: Despite higher rebar prices and manufacturers' ability to pass on the costs, the Steel sector has underperformed (CYTD: -6.1%, FYTD: -11.9%) compared to KSE-100 benchmark (CYTD: +1.6%, FYTD: -6.1%) following economic uncertainty and geopolitical tension. However, we expect earnings to remain robust in the near term as, i) higher rebar prices (+15.4% in 1QFY22) benefits local manufacturers in passing through the cost (higher freight & electricity cost and PkR depreciation), translating into better margins. We prefer ASTL (TP: PkR64/sh, 70% upside) and MUGHAL (TP: PkR179/sh, 83% upside) with stocks currently trading at FY22 P/E of 6.24x/4.38x while on PEG basis, ASTL and MUGHAL is trading at 0.33x/0.16x.

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Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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New Rating Definitions

Buy	> 14.5% expected total return (Rf: 8.5% + Rp: 6%)
Neutral	> 8.5% to < 14.5% expected total return
Sell	< 8.5% expected total return (Rf: 8.5%)



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