Long-Steel Dec'21 earnings preview

Engineering **Overweight**

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Pakistan Equities
Engineering

Key Points

- For 2QFY22 we expect our long steel universe (MUGHAL, ASTL) to post combined net profit of PKR2.9bn, compared to PKR1.3bn of the same period last year, showing a whopping growth of 119%YoY.
- The YoY growth is mainly attributable to higher overall sales amid multiple price hikes during the quarter. Whereas, on sequential basis, profitability of the coverage universe is expected to grow by 26%QoQ.
- Gross margins are estimated at 16% up by 3ppt on YoY basis. However, on QoQ basis, margins are expected to decrease by 1ppts. This YoY increase in gross margins is mainly accredited to record high rebar prices amid healthy demand. Whereas, scrap CNF cost is estimated at ~USD500-520/ton in 2QFY22.
- We maintain our Overweight stance on the sector with MUGHAL as our top pick.

The sector to witness a massive increase in earnings on YoY basis

Next Capital long steel sector coverage universe (ASTL, MUGHAL) is likely to witness healthy increase in earnings during the quarter ending Dec'21 compared to the same period last year. The combined profit after tax is projected to post an increase of 119%YoY. The increase in earnings is mainly attributable to higher sales volume and multiple price hikes. However, we estimate an increase of 26%QoQ in profitability that is mainly affected by PKR depreciation and elevated commodity prices despite increase in rebars prices and sharp rise in volumes during the quarter under review

Volumes to increase both on YoY and QoQ basis

Taking cue from cement offtake, we anticipate long steel demand of our coverage companies (ASTL, MUGHAL) to improve by ~4%YoY and 6%QoQ. This QoQ increase is mainly attributable to low base effect and higher sales on account of anticipated price hikes of rebars due to mounting cost pressures. Individually, we expect MUGHAL's volume to clock in at 96,000/tons as compared to 90,000/tons of 1QFY22 and 91,000/tons of 2QFY21. Likewise, ASTLs' volume to clock in at 93,000/tons as compared to 88,000/tons of 1QFY22 and 90,000/tons of 2QFY21.

Multiple price hike to bode favourably

Average rebar prices during the quarter under review increased by 14%QoQ and 59%YoY to average at PKR190,000/ton. The increase in prices is mainly attributable to rising commodity prices i.e., scrap prices, PKR devaluation and higher tariff cost of 19-21/kwh. Hence, we expect top line of our coverage universe to grow by 58%YoY to clock in at PKR33.6bn as compared to PKR21.2bn of 2QFY21 and PKR25.8bn of 1QFY22.

Volatile exchange rate and elevated commodity prices to keep margins in check

We expect gross profit during the quarter ending Dec'21 in absolute terms to increase to PKR5.4bn compared to PKR2.7bn of Dec'20 and PKR2.7bn of Sep'21. In addition, gross margins are estimated to clock in at 16% against the previous quarter of 17% and 13% in the same period last year. We opine, massive growth in gross margin on YoY basis is mainly attributable to price hikes and higher volumes. However, on QoQ PKR devaluation and higher scrap prices outweigh both price and volume increase.

Outlook

We maintain our overweight stance on the sector preferring only MUGHAL due to its successful diversification into non-ferrous business. Going forward, we expect demand to slow down on the back of contraction on both fiscal and monetary fronts. Having said this, major projects announced like Mera Ghar Mera Pakistan and Low-cost housing Scheme may somewhat provide breather we opine. In addition, Private sector construction has remained resilient where graded rebars are preferred in construction by individuals. With access to financing we expect private construction activities to remain upbeat. Moreover, with marketing and educational campaigns rebars manufacturers are trying to shift users from sub-standard to quality rebars. Although the process of migration will take time but it will keep expanding the market of graded rebars. Further, higher remittances and better farm economics have played a key role in higher level of construction. Moreover, as the sector is relying extensively on imported raw materials, the sector is highly susceptible to volatilities in the exchange rate. With PKR having already lost substantial ground against the greenback and awaiting further brunt in the coming months, the cost of production is becoming inevitably high. However, given a long-term robust demand outlook, import competitive prices and almost no competition threat from ungraded players, we expect re-bar players to enjoy pricing power. However, the frequency of price increase to limit going forward hence margins likely to normalize going forward.

Key Data

Mkt. Cap. (USDmn)	789
Mkt. Cap. (PKRbn)	139
Index Weightage (KSE-100)	1.9%
Number of Listed Companies	14

Source: PSX, Next Research

2QFY22 Sector Estimates

EPS	2QFY22E	YoY	QoQ	DPS
MUGHAL	6.02	93%	20%	1.5
ASTL	3.23	207%	41%	-

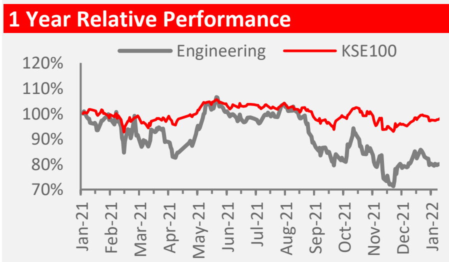
Source: Company Accounts, Next Research

Cumulative Sector Estimates

EPS	1HFY22	1HFY21	YoY
MUGHAL	11.05	4.17	165%
ASTL	5.53	1.42	289%

Source: Company Accounts, Next Research

1 Year Relative Performance



Source: PSX, Next Research

M Shumail Rauf
+92-21-35222204
shumail.rauf@nextcapital.com.pk

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Under Weight	< Weight in KSE 100 Index

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R = Expected Dividend Yield + Expected Capital Gain
R' is before tax
Investment horizon is between six months to twelve months

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Karachi Head Office
2nd Floor Imperial Court Building,
Dr. Ziauddin Ahmed Road,
Karachi75530 , Pakistan

☏: +92-21-111-639-825
🖷: +92-21-35632321

Lahore Office
63-A, Agora Eden City
DHA Phase VIII,
Lahore, Pakistan

☏: +92-42-37135843-8
🖷: +92-42-37135840

Research
☏: 92-21-111-639-825 (Ext:109, 129)
✉: research@nextcapital.com.pk

Sales and Trading
☏: 92-21-111-639-825 (Ext: 106)
✉: equitysales@nextcapital.com.pk

Corporate Finance & Advisory
☏: 92-21-111-639-825 (Ext: 131)
✉: cf@nextcapital.com.pk

www.nextcapital.com.pk