Agha Steel Industries Ltd.

PKR13.8 - BUY

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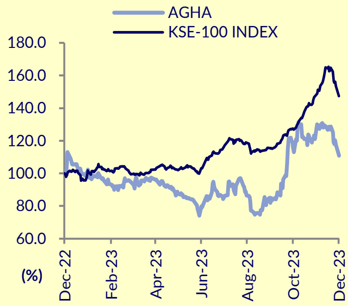
Pakistan

Engineering

Bloomberg	**AGHA PA**
Reuters	**AGHA.PSX**
Priced on 28 December 2023	
KSE100 @ 62,052.2	
12M hi/lo	PKR16.2/9.1
Dec-24 price target	PKR25.4
±% potential	+84.5%
Shares in issue	604.9m
Free float	40.0%
Mkt. cap	USD29.6m
3M ADV	USD0.1m

AGHA vs. KSE100 performance



Source: PSX, Bloomberg

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Vertical Integration to propel profitability

MiDa to substantially reduce reheating cost and wastages

Agha Steel Industries Limited (AGHA) is on the verge of transformation with MiDa expected to commence commercial operations in 4QFY24. This will add 400KTPA to the rebar capacity, increasing it by 160% of the existing capacity. Moreover, the company has also procured blast furnace of 45KTPA capacity and if this experiment of mini-furnace goes well then company may enhance that capacity to meet its entire raw material requirement. These developments are likely to cut raw material and energy costs, leading to upsurge in profitability. We posit that company's earnings will expectedly grow at a 3-year CAGR of 72% from FY23-26. At our Dec-24 target price of PKR25.42/sh, company offers upside potential of 84.4% from the last close.

MiDa plant to cut production costs: Newly installed MiDa plant was energized on 23rd November, marking completion of first phase of cold commissioning. With the second phase of cold commissioning on-going, commercial operations are expected to begin in 4QFY24. As per management, through MiDa, the continuous casting will eliminate the need for billet reheating. This uninterrupted casting will cut furnace oil / natural gas needs, effectively reducing production cost by 1.7%.

MiDa also has OEM guaranteed yield of greater than 99.5%, compared to prevailing industry benchmark re-rolling wastage of 2%. Thus, company is also expected to save additional ~1.2% of cost with reduced wastages. These cost savings will propel company's earnings which we posit will grow at a 3year CAGR of 72% through FY26. These figures assume 120KT rebar offtake in FY25 i.e. first full year of MiDA operations and thereafter increasing its volumetric sales at 15% per annum for next few years as the company can gain market share due to its cost advantage. We have assumed PKR5,000/Ton discount on any incremental sales over organic industry growth assumption of 7% per annum.

Plans to integrate backwards: Company plans to lessen its reliance on imported raw material and has thus procured a mini blast furnace of 45KTPA capacity to make steel from iron ore. If this proves to be successful, the company may shift entirely to local sources to meet its raw material needs, effectively shielding it from adverse currency movements. AGHA is one of the prime suppliers of re-bars to government projects due to its ability to make steel with customized usage of ferro-alloys in its electric arc furnace. Hence, the transport vehicles that take its product to Dams construction sites in North can be used to transport iron ore from KPK on their way back to Karachi.

Financials Snapshot

Key metrics	FY22	FY23	FY24E	FY25E	FY26E
EPS	3.07	1.50	1.87	4.22	7.78
Earning Growth	-9%	-51%	25%	125%	84%
P/E	4.5	9.1	7.3	3.2	1.8
DPS	0.0	0.0	0.0	0.0	0.0
Dividend Yield	0%	0%	0%	0%	0%
P/BV	0.53	0.49	0.47	0.41	0.33
BVPS	25.9	27.4	29.3	33.5	41.3
ROA	4.8%	2.2%	2.6%	5.4%	9.1%
ROE	12.6%	5.6%	6.6%	13.4%	20.8%

Source: Company Accounts, Alfalah CLSA Research

Company plans to use local coal instead of metallurgical coal / coke (typical for large blast furnaces) as local coal is available at steep discount. Moreover, company already has arrangements with operators of limestone quarries in Jhimpir which will act as a fluxing agent. We estimate that at 100% capacity utilization, blast furnace will result save PKR0.9bn in raw material and power cost but incur additional PKR0.3bn in finance cost and depreciation. Hence, it will result in incremental EPS of PKR0.6. We have incorporated it from FY26 onwards in our estimates.

Striving to become net exporter: Company also plans to export iron ore and thus become net exporter in coming time. However, we have not incorporated these into our financial models as axle load implementation will make transport charges from Northern KPK (company's current iron ore source) excessive to earn healthy export margins. However, exports become feasible if company sources iron ore from Mastung/Kalat/DG Khan but currently company hasn't developed commercial relations with mine operators in these regions.

Financial Performance: Company's profitability will improve significantly enabling it to reduce its financial leverage. We expect that over 2 years, earnings will increase to PKR7.78 in FY26 from PKR1.87 in FY24. Moreover, its debt to asset ratio will likely fall to 47% in FY26 from 56% in FY24. A brief snapshot of profitability and financial strength is depicted in tables below.

Figure 1

Snapshot of Profit and Loss Statement

	FY22	FY23	FY24E	FY25E	FY26E
Net Revenue	25,647	20,582	23,885	32,414	39,224
Gross Profit	5,489	4,820	6,764	9,927	12,796
EBIT	4,422	4,377	5,973	8,528	11,038
PBT	2,286	1,168	1,808	4,177	7,705
PAT	1,852	905	1,130	2,548	4,701
EPS	3.07	1.50	1.87	4.22	7.78

Source: Company Account, Alfalah CLSA Research

Figure 2

Snapshot of Balance Sheet

	FY22	FY23	FY24E	FY25E	FY26E
PPE	19,149	21,277	22,047	21,418	20,838
Total Non-Current Assets	19,675	21,768	22,535	21,906	21,326
Stock In Trade	12,299	10,440	12,486	14,282	16,258
Trade Debts	5,272	4,949	5,323	7,071	8,557
Cash	215	87	167	678	1,704
Total Current Assets	21,801	20,211	22,916	27,293	32,288
Total Equity	15,666	16,571	17,701	20,249	24,948
Long Term Loans	5,403	4,224	6,912	6,202	5,215
Total Non-Current Liabilities	6,571	5,897	8,633	7,923	6,936
Payables	1,129	829	519	1,151	1,353
Short Term Borrowings	14,046	13,729	16,991	17,999	18,490
Total Current Liabilities	19,239	19,512	19,117	21,027	21,729

Source: Company Account, Alfalah CLSA Research

Valuation and Recommendation: We have used discounted cash flow models to value Agha Steel Industries Limited. We assign a BUY rating to the company with a Dec-24 target price of PKR25.42/share, providing upside potential of 84.4% from the last close.

Risk factors

Devaluation of currency

Imposition of customs duty on DRI

Abolishment of anti-dumping duty on imported rebars by NTC

Increased competition from local re-rollers

Higher Interest rates

Economic Slowdown leading to lower steel demand from public sector

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