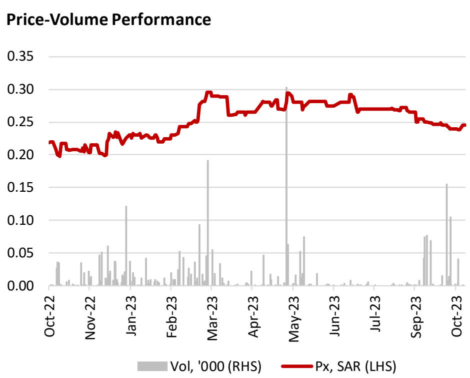
Al Jazeera Steel (ATMI)

Target Price: OMR 0.276
Upside: 12.5%

Recommendation	**Accumulate**
Bloomberg Ticker	ATMI OM
Current Market Price (OMR)	0.245
52wk High / Low (OMR)	0.300/0.200
12m Average Vol. (000)	58.3
Mkt. Cap. (USD/OMR Mn)	80/31
Shares Outstanding (mn)	124.9
Free Float (%)	43%
3m Avg Daily Turnover (SAR'000)	11.1
6m Avg Daily Turnover (SAR'000)	12.8
P/E'23e (x)	10.60
EV/EBITDA'23e (x)	5.10
Dividend Yield '23e (%)	4.70%
Price Performance:	
1 month (%)	(1.61)
3 month (%)	(9.26)
12 month (%)	9.37

Source: Bloomberg, U Capital Research; valued as of 19 Oct 2023



Source: Bloomberg

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- **Expected increase in construction activities in the GCC to support volume growth**
- **Capacity utilization could expand to ~80% by FY27e from current levels of ~70% driven by geographic as well as product expansion**
- **Strong fundamentals: lower debt ratio enable ATMI to facilitate the upgradation of production facilities in Oman through internal accruals**
- **Earnings under pressure in the short-term, recovery expected beyond FY24e**

We review our coverage on Al Jazeera Steel (ATMI) and assign an **Accumulate** rating with a target price of OMR 0.276 per share, offering an upside of 12.5% on the current stock price. Based on our estimates, the stock currently trades at a P/E multiple of 10.6x which is 49% discount to peers' average of one year forward P/E of 21.1x. In terms of EV/EBITDA, the stock trades at a multiple of 5.1x, which is ~46% discount to the peers' average.

Investment Thesis:

ATMI based in Oman, is a leading steel producer with a total annual production capacity of 600,000mt, evenly divided between tube mill and merchant bar. They manufacture a diverse product range, including black pipes, galvanized pipes, hollow sections, merchant bar mill products, and rebars, serving applications in construction, irrigation, agriculture, steam and gas facilities, water, and sanitation. The company's 71% of FY22 revenue came from the GCC, 20% from North America, and 9% from other countries, with the merchant bar segment contributing the highest percentage to sales.

i) Higher demand visibility driven by strong construction projects pipeline in Oman and other GCC countries

ii) The company intends to diversify to a product range which is less sensitive to volatility in steel prices

ii) Utilization rate to improve to 75-80% over the medium term

iii) EBITDA margins and ROE to grow gradually to reach 7-8% and 16-17% respectively by FY27e, closer to highest levels in FY21

iv) Liquidity position to remain solid with an expected improvement in profitability and low capex requirements; ample liquidity should also ensure sustained dividend payments (average dividend payout during FY23-27e: ~46%).

Financial and valuation summary:

	FY20	FY21	FY22	FY23e	FY24e	FY25e
Revenues (OMR mn)	88.5	150.4	149.3	141.4	149.7	158.4
Net income (OMR mn)	3.1	9.2	3.1	2.9	3.5	4.9
Gross margin	12.3%	16.1%	13.0%	12.8%	13.1%	14.3%
Net profit margin	3.5%	6.1%	2.1%	2.0%	2.3%	3.1%
RoE	7.0%	18.3%	6.3%	5.8%	6.8%	9.1%
DPS (OMR/share)	0.03	0.03	0.02	0.01	0.01	0.02
P/E	5.5x	5.0x	8.7x	10.6x	8.8x	6.3x
EV/EBITDA	5.3x	4.9x	7.8x	5.1x	5.3x	4.3x

*Source: Company Reports, U Capital Research *P/E and EV/EBITDA from 2023 onwards calculated on price of 19/10/2023*

Investment Summary

Demand to pick up with higher construction activities in GCC

Oman, Saudi Arabia, and the UAE have been focusing on diversifying their economies to reduce their dependence on energy prices and to raise contributions from the non-oil sector. To fulfill these objectives, these countries are carrying out long-term strategic plans under 'Vision 2040' for Oman, 'Vision 2030' for Saudi Arabia, and 'Abu Dhabi Vision 2030/Dubai Vision 2040' in the UAE.

Anticipating a surge in construction activities within the GCC region, particularly driving the demand for construction materials like steel, we expect a corresponding increase in the demand for ATMI's products. This surge in demand is poised to elevate utilization rates. It is important to note that the company has made substantial investments in upgrading its production facilities, further enhancing its utilization. The company is expected to benefit from these investments from FY24e onwards.

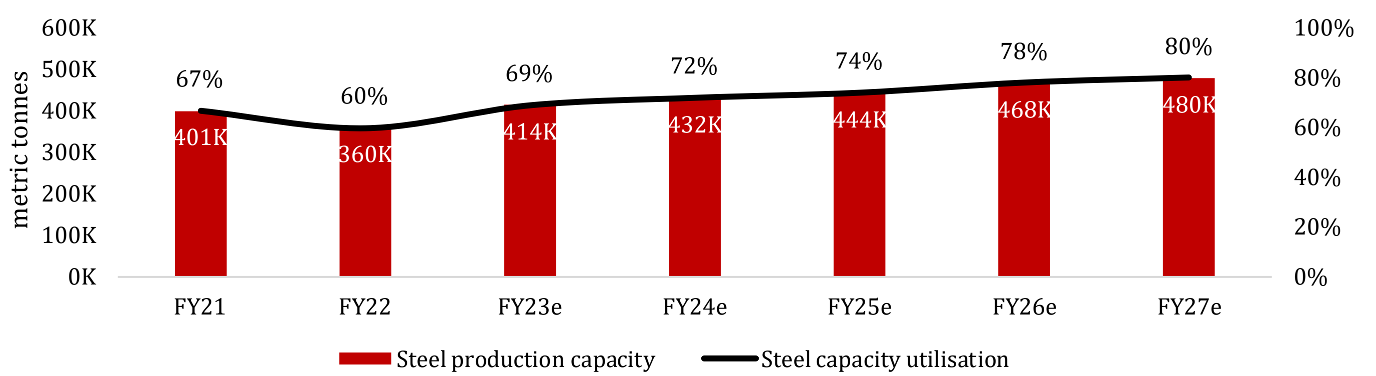
Ample potential for capacity utilization growth

Throughout FY17 to FY22, the company has consistently maintained a production capacity utilization rate within the 60-70% range. This remarkable stability persisted even in the face of economic challenges brought about by various government austerity measures designed to bolster fiscal positions, particularly in response to declining oil prices. Notably, in the tumultuous year of 2020, marked by the global pandemic, the company achieved a utilization rate of 62%, underscoring its operational resilience.

The company is expanding its reach into other markets, not limited to geographical expansion. In order to reduce dependency on commodity distribution sectors they are exploring other segments like transmission towers, which offer greater price stability and higher returns. The company is focussing on Africa, Europe and other small markets.

Accordingly, we have assumed that the company's plant utilization to improve steadily from 70% in 2Q23 to 74% in FY25e and 80% by FY27e. On similar lines, we have estimated the rise in production volumes from 414k mt in FY23e to 480k mt in FY27e, assuming the rise in demand with ongoing strategic activities in the GCC region.

Fig. 1: Capacity utilization to grow with the rise in demand



Revenues: significant dependance on steel price

During 9M23, the company reported a decline of 8% in its revenue and assuming a slight revival in the 4Q23e, we are estimating a YoY downtrend of 5% in FY23e revenue. Our estimates are conservative and projected a revenue CAGR of 7% during FY23-27e which is ess than the average annual growth rate of ~12% during FY17-21.

Like any typical manufacturing company, ATMI's revenues are a function of sales volume and price.

Volumes: On the volume side, except for FY20 (371k) and FY22 (360K), the company has shown a good level of resiliency as volume remained in the range of 400-420k during FY17-22. We expect volumes to grow by 5% annually during FY23-27e on expectations of efficient production facilities and better demand conditions.

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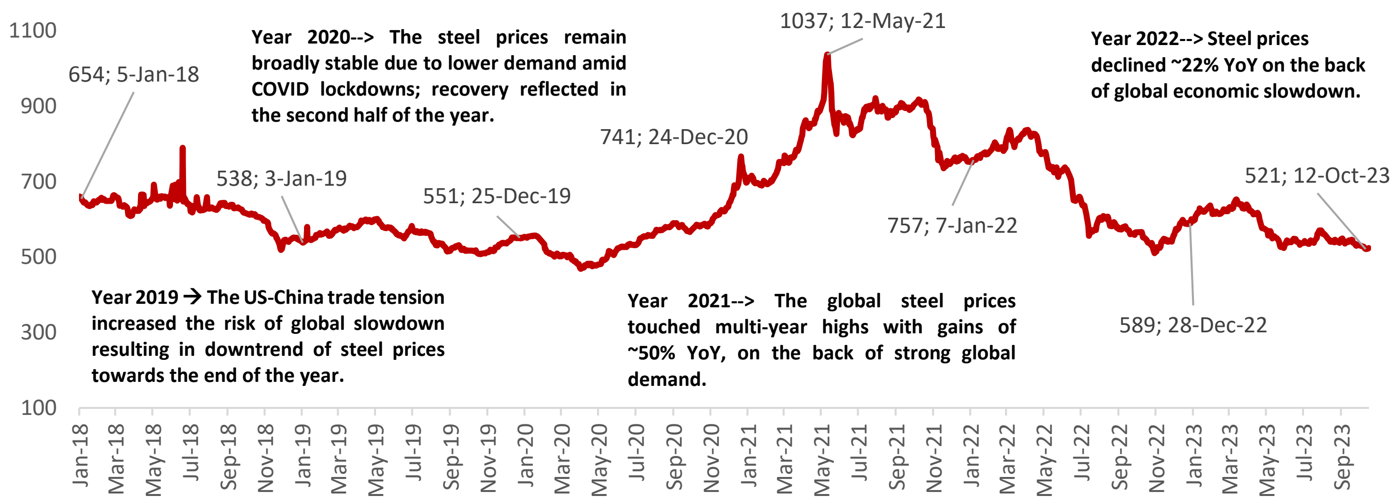
Price: Historically, global macro-economic events have significantly impacted the steel price movements. The chart below shows the steel price variations since January 2018.

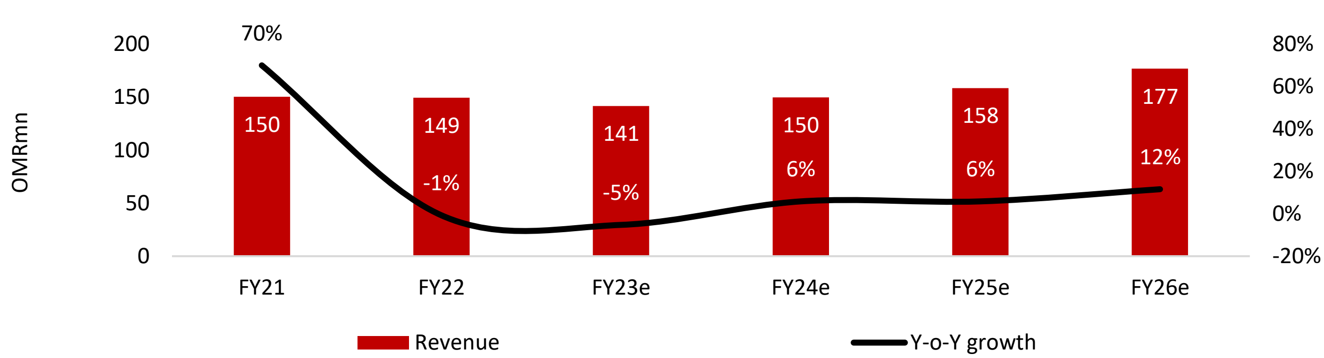
In FY18, the company realized steel prices were up ~16% YoY, broadly tracking global steel prices, also the strong global economy led to higher demand and was further supported by tariffs imposed by the Trump administration. In FY19, the company realizations declined by 8% YoY on account of deteriorating investment sentiments amid escalating trade tensions between the US and China which increased the risks of a global slowdown. In FY20, realized steel prices were down by 7% YoY mainly due to lower demand amid lockdowns to combat COVID-19 while global prices were broadly flat reflecting a recovery in the second half of the year. The year 2021 was an exceptional year for the steel sector as well as for ATMI as global steel prices touched multi-year highs with gains of around 50% YoY while company realizations were up 57% YoY. Steel prices saw an uptick at the start of 2022, however, as the global economy began facing slowdown, the steel prices tumble towards the end of the year.

Fig. 2: Global steel prices often impacted by macro-economic events



For FY23, there has been a ~20% decline in company realizations during the first three quarters of the year mainly due to high interest rate environment and global slowdown. For the final quarter, we expect a slight improvement in the global economy and thus expect the company realizations to decline by ~16% YoY. Considering volatility in steel prices and its dependency on the global economic environment, we are expecting the average realized prices to increase by 1.5% YoY in FY24e, and 2% each in FY25e, FY26e, and FY27e on a YoY basis. We have followed a conservative approach in terms of steel price realizations for the forecasted period amid uncertainties around the commodity prices.

Fig. 3: Revenue to grow consistently from FY24e



Source: Company Reports, U Capital Research

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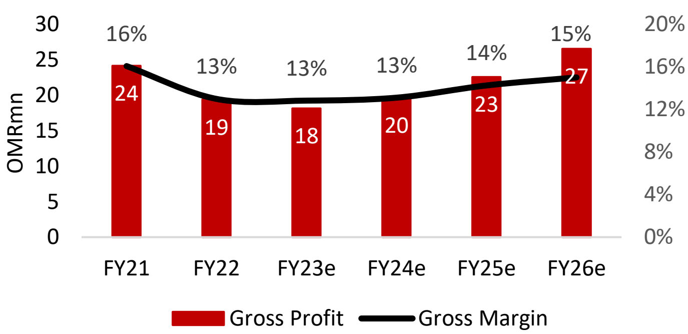
Profitability to grow on the back of higher capacity utilization

We have projected gross margins at 12.8% in FY23e compared to 13.0% in FY22. In the first half of FY22, the company enjoyed exceptional profits, driven by a significant shortage of materials caused by geopolitical tensions, particularly related to Russia and Ukraine. This led to a substantial increase in prices and boosted the company's profit margins. In contrast, during 1H23, despite the continued decline in prices, the company maintained its operational profitability.

By FY27e, margins are expected to reach ~16% reflecting our assumption of higher capacity utilization and steady growth in steel prices. Furthermore, diversification into a product range which provides stable returns is expected to benefit margins in the future.

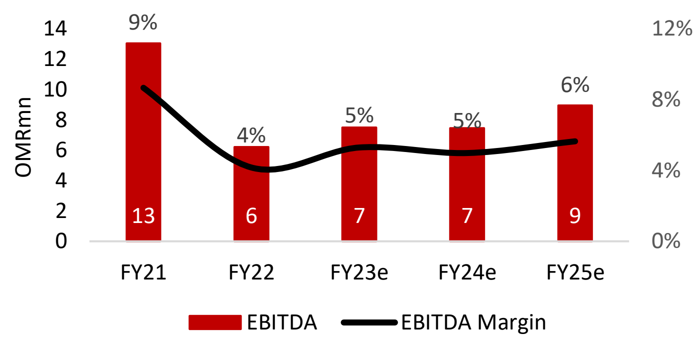
For EBITDA margins, we expect them to improve to a range of 7-8% by the end of FY27e against the level of 4-5% in FY22-23e. We have assumed that the raw material prices, G&A expenses and selling and distribution expenses to grow at a CAGR of 6%, 2.5% and 11.6% respectively, during FY23-27e.

Fig. 4: Gross margins seen largely in uptrend



Source: Company Reports, U Capital Research

Fig. 5: EBITDA margins to improve as well



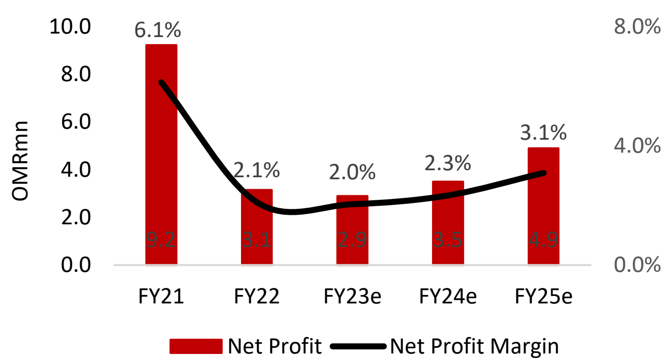
Source: Company Reports, U Capital Research

Bottom line recovery expected from FY24e onwards

For FY23e, Net income is expected to reach OMR 2.9mn keeping net margins at FY22 levels of 2-2.2%. Going forward, we expect the company earnings to improve under the assumption of YoY rise of 1.5-2% in steel prices and higher sales volume over the forecast period. Accordingly, we have estimated the company's bottom line to grow to OMR 9.5mn by FY27e while the net margins are expected to improve to 5.1%.

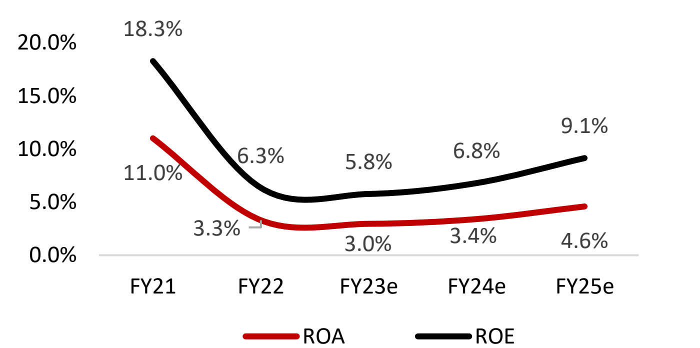
We expect that the ROE and ROA to decline in FY23e in line with our net income expectations. From FY24e, we see a recovery in return ratios to higher net income backed by higher revenues and improved margins.

Fig. 6: Net profit margin to recover from FY24e onwards



Source: Company Reports, U Capital Research

Fig. 7: ROA and ROE to decline in FY23e



Source: Company Reports, U Capital Research

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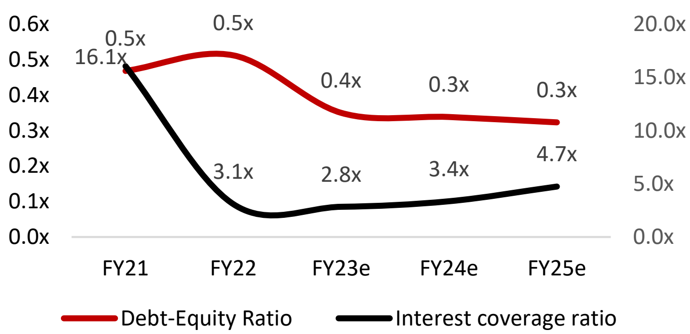
Healthy balance sheet to support consistent dividend payout

The company continues to maintain a solid financial position in terms of low debt to equity levels (0.5x in FY22), good cash balance, and a decent cash conversion cycle, despite a volatility in earnings. Going forward, we have projected the company's balance sheet to strengthen further with low capex requirements and decent earnings over the medium term. The debt-to-equity ratio is expected to decline to 0.3x by FY27e while managing cash balance and dividend payments.

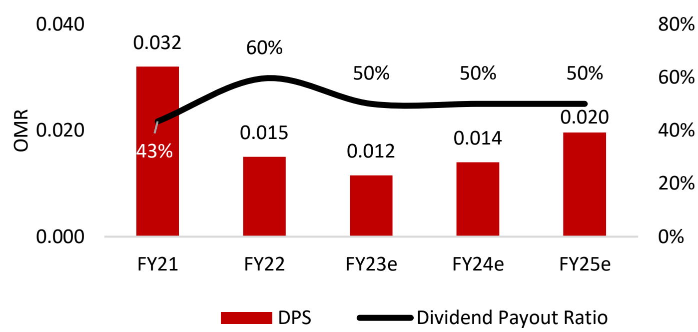
In addition, we are expecting that the company will continue to reward its shareholders with a dividend payout of 50% during FY23e, FY24e and FY25e. For FY26e and FY27e, we considered a conservative approach assuming internal cash flows towards maintenance capex and thus expected a dividend payout of 40% only.

Fig. 8: Maintaining a lower D/E ratio



Source: Company Reports, U Capital Research

Fig. 9: Payout ratio to remain stable in the range of 40-50%



Source: Company Reports, U Capital Research

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Valuation

We have used DCF, DDM, and P/E -based valuation multiple by assigning equal weightage to each of these to derive the target price. For DCF and DDM, we have used a 5-year explicit forecast period (2023-27) and afterward have assumed a 2% terminal growth rate. We have then calculated the present value of future cash flows/dividends (Enterprise Value/Fair Value) using the weighted average cost of capital (WACC). After arriving at the enterprise value, we have made the required adjustments such as net debt, minorities, and Employee retirement benefits to derive equity value for the company. For the relative valuation, we have taken the 45% discount to the mean of 12M Forward P/E multiple of relevant peers and then the multiples are multiplied by the forecasted FY 23e EPS.

	ATMI
DCF (Equal weight)	
PV of Free Cash Flow (SAR mn)	
Year 1	5,708
Year 2	241
Year 3	2,404
Year 4	1,162
Year 5	4,573
Terminal Value	88,031
PV Terminal Value	59,246
Less: Debt	(29,853)
Less: Minority Interest	(129)
Less: Employee retirement obligations	(10,822)
Add: Cash & Investments	3,986
Equity value (SAR mn)	36,516
Outstanding shares (mn)	124,898
Target Price (SAR)	***0.292***
DDM (Equal weight)	
PV of Dividends (SAR mn)	
Year 1	1,838
Year 2	1,288
Year 3	1,419
Year 4	1,810
Year 5	1,927
Terminal Value	37,087
PV Terminal Value	24,960
Fair value	33,241
Target Price (SAR)	***0.266***
Assumptions	
Risk Free Rate (%)	6.1%
Adjusted Beta	0.81
Risk Premium (%)	7%
Cost of Equity (COE) (%)	11.8%
WACC (%)	9.9%
P/E based Relative Valuation (Equal weight)	
Target P/E multiple for 2023e	*11.61*
EPS 2023e (SAR)	*0.02*
Target Price (SAR)	***0.268***
Weighted Average Target Price (SAR)	
Current Market Price (SAR)	*0.276*
Upside/(Downside), %	*12.5%*
Recommendation	**ACCUMULATE**

Source: Company Financials, Bloomberg, U Capital Research

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Peer Group Valuation

Name	Mkt Cap (OMR mn)	Last Px (OMR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITDA'23e, (x)	P/E'23e, (x)	ROE'23e, (%)	Div Yield' 23e, (%)	FCF Yield TTM (%)
Steel										
SAUDI STEEL PIPE CO	180.0	3.53	-5	26	95	12.1	19.3	20.1%	na	-0.8%
SONASID	100.2	25.69	33	25	42	6.6	37.2	3.1%	3.0%	0.9%
DELTA HOLDING SA	123.2	1.41	25	10	54	8.4	17.6	na	3.8%	-5.7%
AL JAZEERA STEEL PRODUCTS CO	30.6	0.25	-2	-9	9	5.1	10.6	5.8%	4.7%	5.2%
Average						**8.1**	**21.2**	**9.7%**	**3.8%**	**-0.1%**
Median						**7.5**	**18.5**	**5.8%**	**3.8%**	**0.1%**

Source: Bloomberg, U Capital Research, na – not available

Risks to Valuation

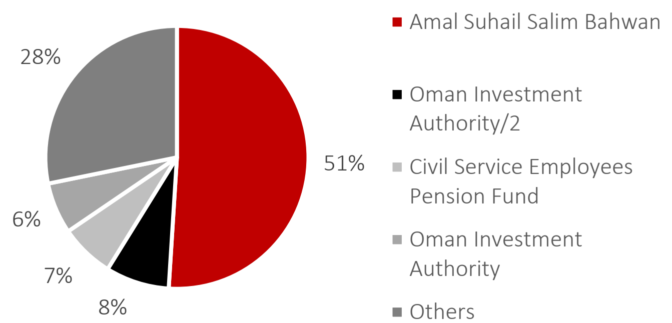
Key downside risks to our valuations include:

- Decline in steel prices with a slowdown in the economy.
- Higher raw material prices negatively impact the gross margins.
- No hedging of raw material prices.
- Higher interest rate environment continues for a longer period

Key upside risks to our valuations include:

- Higher construction activities leading to an increase in steel demand.
- Increase in operating margins with control of S&D expenses.

Key Shareholders



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Key financials

In OMR mn, except stated otherwise	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Sales	88	150	149	141	150	158
Cost of sales	(78)	(126)	(130)	(123)	(130)	(136)
Gross profit	**11**	**24**	**19**	**18**	**20**	**23**
Depreciation and amortization	2	2	2	2	2	2
General and administrative expenses	(3)	(3)	(4)	(4)	(5)	(4)
Operating profit	**3**	**11**	**4**	**5**	**5**	**7**
Other Income	1	0	1	0	0	0
Finance costs	(1)	(1)	(1)	(2)	(1)	(1)
Income before tax	**4**	**11**	**4**	**3**	**4**	**6**
Income tax	(1)	(2)	(1)	(1)	(1)	(1)
Net income for equity shareholders	**3**	**9**	**3**	**3**	**3**	**5**
Balance Sheet						
Inventories	18	23	31	25	27	28
Trade and other receivables	33	50	41	38	41	43
Cash and bank balances	4	7	6	12	11	12
Property and equipment	16	15	14	14	15	15
Right-of-use assets	0	1	1	10	10	10
Total assets	**71**	**96**	**94**	**101**	**105**	**109**
Loans and borrowings	13	24	25	18	18	18
Trade and other payables	11	18	16	17	18	19
Lease liabilities	1	1	2	2	2	2
Total liabilities	**27**	**46**	**45**	**50**	**52**	**54**
Share capital	12	12	12	12	12	12
Retained earnings	14	20	19	20	22	24
Equity Attributable to Shareholders	**44**	**50**	**50**	**51**	**52**	**55**
Cash Flow Statement						
Net cash generated from operating activities	(1)	(3)	4	18	4	6
Net cash generated from investing activities	0	0	-2	(1)	(3)	(2)
Net cash (used in) provided by financing activities	1	7	(4)	(11)	(2)	(3)
Cash and cash equivalents at the end of the period	**4**	**7**	**6**	**12**	**11**	**12**
Key Ratios						
Gross margin (%)	12.3%	16.1%	13.0%	12.8%	13.1%	14.3%
EBITDA margin (%)	5.6%	8.7%	4.2%	5.3%	5.0%	5.6%
Operating margin (%)	3.7%	7.5%	3.0%	3.5%	3.4%	4.1%
Net margin (%)	3.5%	6.1%	2.1%	2.0%	2.3%	3.1%
ROA	4.5%	11.0%	3.3%	3.0%	3.4%	4.6%
ROE	7.0%	18.3%	6.3%	5.8%	6.8%	9.1%
Current Ratio (x)	2.2	1.9	1.9	2.1	2.1	2.2
Capex/Sales	0.7%	0.8%	1.6%	7.6%	2.2%	1.4%
Debt-Equity Ratio (x)	0.29	0.47	0.51	0.35	0.34	0.32
EPS	0.025	0.074	0.025	0.023	0.028	0.039
BVPS	0.356	0.404	0.397	0.405	0.419	0.438
DPS	0.026	0.032	0.015	0.012	0.014	0.020
Dividend Payout Ratio	104.6%	43.4%	59.6%	50.0%	50.0%	50.0%
Dividend Yield (%)	19.0%	8.7%	6.8%	4.7%	5.7%	8.0%
P/E (x)	5.5	5.0	8.7	10.6	8.8	6.3
P/BV (x)	0.4	0.9	0.6	0.6	0.6	0.6
EV/EBITDA (x)	5.3	4.9	7.8	5.1	5.3	4.3
Price as at period end*	0.137	0.368	0.220	0.245	0.245	0.245

Source: Company Reports, U Capital Research ***Current market price is used for forecast periods**

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Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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