RATING REPORT

International Industries Limited (IIL)

REPORT DATE:
April 25, 2018

RATING ANALYSTS:

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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**AA-/A-1**	**AA-/A-1**
Rating Date	*April 10, 2018*	*January 13, 2017*
Rating Outlook	Stable	Stable
Outlook Date	*April 10, 2018*	*January 13, 2017*

COMPANY INFORMATION	
Incorporated in 1949	**External auditors:** M/s KPMG Taseer Hadi & Co.
Public Listed Company	**Chairman of the Board:** Mr. Mustapha A. Chinoy
	Chief Executive Officer: Mr. Riyaz T. Chinoy
Key Stakeholders (with stake 5% or more):	
Directors, CEO, Sponsors and Family Members- 50.49%	
Govt. Financial Institutions & Associates- 6.75%	
Banks, DFI & NBFI and Insurance Companies- 10.38%	
Mutual Funds- 7.42%	
General Public- 18.68%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.jcrvis.com.pk/kc-meth.aspx

International Industries Limited (IIL)

RATING RATIONALE

International Industries Limited (IIL) is Pakistan's largest manufacturer of steel and plastic pipe with an annual pipe manufacturing capacity of 750,000MT. The company commenced operations of its large diameter pipe mill for Hollow Structural Sections (HSS) & API pipes and HDPE pipe up to 1,600mm extruder in 2016. This along with inauguration of PPRC pipes and fittings factory in Sheikhupura is expected to facilitate sizeable volumetric growth in sales, going forward. The management is considering a number of projects as part of its growth and diversification initiatives.

Sales Mix

Sales mix of IIL is diversified in terms of local and export sales and comprises multiple products from the two segments (steel and plastic). Overall sales volumes increased by 2% during FY17 and stood at 207,678MT (FY16: 204,241 MT); local sales increased by 8% during FY17 while exports declined by 11%. Resultantly, contribution of local sales volumes in sales mix increased to 71% (FY16: 67%) during FY17.

Steel Pipes Segment

In terms of volumes, galvanized and CR pipes represent around four-fifth of total steel segment sales with remaining sales being generated through black and API pipes. During FY17, increase in sales volumes was witnessed across all major segments including galvanized, CR and black pipes. Going forward, broad based growth in sales is expected during FY18 on account of order pipeline for API pipes based on tenders awarded & ongoing pipeline infrastructure development activity in the country and healthy demand outlook for CR pipes (increasing automobile sales), scaffolding pipes (higher construction activity) and galvanized pipes (increased government focus on gas outreach in the election year). Export sales, primarily comprising sales of galvanized pipes, after witnessing a decline during FY16 and FY17 are expected to post growth in FY18 due to improved sales from new markets.

Plastic Pipes Segment

Sales volumes and gross margins from the plastic segment exhibited a decline during FY17 on account of lower tender based orders and increased competition of low quality manufacturers. With increased orders from tender based business and commencement of operations of PPRC pipes & fitting manufacturing facility which will supplement sales of plastic pipes, the segment is expected to record robust sales growth in FY18.

Business Risk

Steel sector is characterized by high business risk given the cyclical nature of the industry, volatility in steel prices (HRC prices hovered in the range of $370-$570 per MT in the outgoing year) and threat of dumping particularly from China. Duties on pipe imports along with IIL's strategy of keeping margins at competitive levels has facilitated in partly mitigating competition from imports.

Profitability

Net sales of IIL recorded an increase of 12.7% during FY17. Despite increase in raw material prices, gross margins of the company were reported higher at 17% (FY16: 16.7%) in FY17 on account of inventory gains. While remaining at healthy levels and higher than historical gross margins, JCR-VIS expects full year gross margins for FY18 to witness a slight decline owing to higher proportion of tender based orders in sales mix. Moreover, chances of significant inventory loss from current levels in case of sharp decline in steel prices is limited given that average cost of inventory carried on the balance sheet is significantly lower vis-à-vis current steel prices and strong pricing power enjoyed by IIL due to sizeable market share. With raw materials representing the major cost component and significant volatility in prices, efficient procurement and inventory management will remain critical to gross margins. Comfort is also drawn from the extensive experience and track record of sponsors in

OVERVIEW OF THE INSTITUTION

International Industries Limited (IIL) was incorporated in Pakistan in 1948 and is quoted on the Pakistan Stock Exchange (PSX). IIL is in the business of manufacturing and marketing of galvanized steel pipes, precision steel tubes, API line pipes and polyethylene pipes.

To cater to its power related needs, IIL has an in-house co-generation plant with capacity of 4MW which is a source of competitive advantage. Excess power generated is sold to K-Electric Limited (KEL). The company also has investments in subsidiaries and associates with the most significant one being in International Steels Limited (ISL) amounting to Rs. 2.45b or 56% stake holding.

Major shareholders of the company include Directors, CEO, Sponsors and Family members who collectively hold 50.49% of the shares. Remaining shareholding is held by general public (18.6%) and financial institutions.

As at March 31, 2018, IIL's subsidiaries include International Steels Limited (ISL) and IIL Australia Pty.

Limited and associated company- Pakistan Cables Limited (PCL). IIL holds 17.124% shares of PCL. In BoD dated 20-04-2018, the directors have recommended to purchase right shares offered by PCL. This proposal will be placed in the Extra Ordinary General Meeting (EOGM) dated 21-May-2018. The proposal is to purchase further 1,218,494 right shares (representing 25% of current holding) at the rate of Rs. 160 / Share (including premium of Rs. 150 / Share). This purchase will not increase the overall holding percentage in PCL.

the steel sector. Net profit witnessed significant growth of 134% during FY17 and was facilitated by sizeable increase in dividend income from subsidiary International Steels Limited (ISL). Future profitability of IIL is projected to witness healthy growth on the back of significant volumetric increase in sales and higher dividend income from ISL.

Liquidity and Capitalization

Liquidity profile draws support from healthy cash flows in relation to outstanding obligations and ageing profile of trade debts. However, inventory levels have witnessed a noticeable increase on account of management's prudent strategy to procure raw material for tenders based orders in order to avoid risk of price fluctuation. Resultantly, gearing levels have trended upwards on account of increase in borrowings to fund higher inventory levels. Gearing and leverage stood at 1.23x (FY16: 0.85x) and 1.82x (FY16: 1.28x), respectively at end-FY17. Going forward, gearing levels will depend on orders in hand for tender based business and funding mix with regards to expansion plans of the company. Future trend with respect to leverage indicators will be tracked by JCR-VIS. Adjusted funds flow from operation remains adequate in relation to outstanding obligations and witnessed an increase with higher profitability.

Corporate Governance

Overall corporate governance framework is supported by adequate board composition and oversight, stable and professional management team, strong internal control framework and focus on transparency and disclosures.

International Industries Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY15**	**FY16**	**FY17**
Fixed Assets	3,622	4,852	5,088
Stock-in-Trade	3,653	4,058	8,165
Trade Debts	2,314	1,625	1,982
Cash & Bank Balances	25	16	7
Total Assets	13,138	13,977	18,516
Trade and Other Payables	1,375	1,859	2,996
Long Term Debt	243	1,038	1,178
Short Term Debt	4,814	3,401	6,009
Total Equity	4,782	5,202	5,841
INCOME STATEMENT			
Net Sales	17,674	14,821	16,707
Gross Profit	1,879	2,469	2,840
Operating Profit including income from subsidiary	1,420	1,438	2,618
Profit After Tax	731	786	1,842
RATIO ANALYSIS			
Gross Margin (%)	10.6%	16.7%	17.0%
FFO to Total Debt (x)*	0.21	0.28	0.37
FFO to Long Term Debt (x)*	4.31	1.19	2.24
DSCR (x)*	2.35	3.16	7.89
ROAA (%)	5%	6%	11%
ROAE (%)	16%	16%	33%

**FFO is adjusted and includes dividend income from subsidiary-ISL*

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	International Industries Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
10-Apr-18	AA-	A-1	Stable	Reaffirmed
13-Jan-17	AA-	A-1	Stable	Initial