RATING REPORT

Aisha Steel Mills Limited

REPORT DATE:
October 02, 2018

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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	A-/A-2	A-/A-2
Rating Date	*October 02, 2018*	*October 5, 2017*
Rating Outlook	*Stable*	*Stable*

COMPANY INFORMATION	
Incorporated in 2005	**External auditors:** M/s A. F. Fergusons & Co.
Public Limited Company	**Chairman of the Board:** Mr. Arif Habib
Key Shareholders as on June 30, 2018 (with stake 5% or more):	**Chief Executive Officer:** Dr. Munir Ahmed
Muhammad Arif Habib – 18.7%	
Arif Habib Equity (Pvt.) Ltd – 30.8%	
Metal One Corporation – 7.6%	
Arif Habib Corporation – 6.8%	

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

Aisha Steel Mills Limited (ASL)

RATING RATIONALE

Industry Dynamics and Business Risk

Aisha Steel Mills Limited (ASL) and International Steels Limited (ISL) are the only two local manufacturers in the flat steel sector with a total installed capacity of 1.22m MT (ISL increased its capacity by 500,000 MT in June'2018). Overall demand for flat steel products has depicted healthy double digit growth over the last three years with sales increasing by 17% during FY18 and amounting to 1.29m MT (FY17: 1.1m MT). Demand growth has been driven by the auto, consumer durables, pipes and construction segment. Within flat steel products, growth in sales of galvanized coils at 24% outpaced increase in sales of cold rolled coils (CRC) at 11%. With both local players operating at near full capacity, shortfall in supply in order to cater to growing demand was met through imports. Despite increased duty protection and full year impact of anti-dumping duty (ADD) imposed in 3QFY17, imports continued to be sizeable in FY18 and recorded an increase of 34% in FY18. ISL and ASL recorded sales growth of 10% and 1%, respectively.

JCR-VIS considers flat steels sector to comprise high business risk given the significant volatility in HRC-CRC margins and threat of dumping. Dumping risk has been partly mitigated by imposition of ADD on imports from China and Ukraine which has also improved pricing power as evident from recent price increases by both players. However, dumping from countries on which ADD has not been levied remains a risk. Going forward, JCR-VIS expects demand growth to slow down in the short-term in line with slower economic growth in the backdrop of increasing interest rates and sizeable current account deficit. Moreover, with increasing capacities coming online (ISL has commenced operations, ASL's expansion of 470,000 MT is expected to come online in FY19 and Siddiqsons has announced new capacity of 200,000 tons in 4QFY20) competition amongst existing players is expected to intensify. Industry players expect quantum of imports to witness a noticeable decline given the duty advantage and convenience for customers in case of procurement from local players. However, landed cost of imports is currently only slightly higher vis-à-vis local players. Tapping export market in order to deploy surplus capacities is also considered important. Imposition of 25% duty on import of steel products into United States is expected to act as a challenge in this regard. Given the sizeable exportable surplus in steel producing countries, steel prices are expected to witness pressure going forward.

Operating Performance

The current production capacity of ASL at end-August'2018 stands at 220,000MT. During FY18, ASL's capacity utilization stood at 99% (FY17: 95%) which has facilitated further in reducing conversion costs. In order to cater to rising demand, ASL plans to increase installed capacity to 700,000 MT. The expansion has a cost of Rs. 5.4b and is being funded through a mix of debt (60%) and equity (40%). Equity portion of the cost has been funded through issuance of right shares, proceeds of which have been received in the outgoing year. Enhanced capacity will also include a galvanized line with a capacity of 250,000MT and facilitate in diversifying sales mix. Management is strengthening dealer network in the northern region given commencement of ASL's galvanizing line in December'2018 as significant HDGC demand emanates from the northern region.

Sales and Profitability

Net sales of the company have grown at a CAGR of 26% over the past three years (FY15-FY18). ASL reported net sales revenue of Rs. 18.9b (FY17: Rs. 14.1b) during FY18. Along with slight growth in quantity sold, increase in sales is attributable primarily to 29% higher average selling prices. Proportion of annealed CRC in total sales has increased to 85% (FY17: 78%) in FY18. Around four-fifth of total sales emanate from the auto and allied segment followed by pipes and appliances segment.

Profitability of the company has posted growth in FY18 on the back of higher prime margins (HRC-CRC margins) and improved pricing power due to imposition of ADD. Resultantly, ASL's gross margins increased to 17.5% (FY17: 14.8%) during FY18. Given higher turnover and margins, ASL's net profitability witnessed an increase to Rs. 1.3b (FY17: Rs. 1b) during the outgoing year. Going forward, JCR-VIS expects profitability to decline in FY19 given the lower margins as compared to FY18 levels and higher finance cost with increase in interest rates and growth in quantum of borrowings as debt draw down for expansion materializes.

OVERVIEW OF THE INSTITUTION

Aisha Steel Mills Limited (ASL) was incorporated in Pakistan on May 30, 2005 as a public limited company. The company was formed to carry out its principal business of manufacturing and selling cold rolled steel in coils and sheets. The company commenced its operations on October 1, 2012 with annual capacity of 220,000 MT.

Mr. Arif Habib and his group companies have a cumulative shareholding of 56.4% in ASL as on June 30, 2018. Other investors on that date include Metal One Corporation with holding of 7.6%. The paid up capital of the company has been increased subsequent to June 30, 2017 consequent to allotment of rights issue.

The board is chaired by Mr. Muhammad Arif Habib who is an experienced investment professional and has founded the group. Mr. Arif Habib has significant experience in the brokerage sector. The Management team of ASL is spearheaded by Dr. Munir Ahmed who has 23 years of experience in the steel industry. Dr. Munir holds a PHD in Metallurgy and Material Engineering.

Capitalization

Equity base of the Company increased to Rs. 6.9b (FY17: Rs. 5.5b) at end-FY18 on account of retained profits. However, gearing levels increased on account of higher utilization of short-term borrowings (FY18: Rs. 5b; FY17: Rs. 2.4b) as the company changed its mode of order procurement in order to limit rupee depreciation risk. Stock in trade and trade debt represented 88% of short-term debt as at end-June'2018 indicating mismatch on balance sheet. Given the additional debt draw down to fund expansion plans, leverage indicators are projected to increase going forward. Moreover, with sizeable depreciation of PKR against USD, overall expansion project cost is projected to depict double digit growth. Management plans to fund cost overruns through internal cash flows.

Liquidity

Liquidity profile of the company is considered adequate in view of improving cash flows in relation to outstanding obligations. FFO to Total Debt and FFO to Long Term Debt were reported at 19% (FY17: 18%) and 38% (FY17: 27%), respectively at end-FY18. Given the improvement in cash flows and extended repayment terms for existing long-term debt, debt servicing ability of the company is considered strong and was reported at 3.13x (FY17: 1.76x) at end-FY18. While remaining adequate, debt servicing coverage is projected to decline from FY21 onwards when repayment of long-term debt for expansion commences. Current ratio of the company was reported below 1(x) due to high levels of short term borrowings and was reported at 0.87(x) at end-FY18.

Aisha Steel Mills Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**
Fixed Assets	9,996	9,689	10,543	13,374
Deferred Tax Asset	1,110	1,134	1,358	933
Stock-in-Trade	2,434	2,814	3,716	4,312
Trade Debts	76	77	152	105
Cash & Bank Balances	132	45	861	46
Total Assets	15,337	15,353	18,184	20,426
Trade and Other Payables	2,744	2,773	3,561	1,210
Long Term Debt	5,618	5,827	5,289	5,390
Short Term Debt	3,876	3,870	2,435	5,045
Total Debt	9,494	9,697	7,724	10,435
Total Equity	2,420	2,273	5,476	6,933
INCOME STATEMENT				
Net Sales	9,492	9,634	14,076	18,904
Gross Profit	41	980	2,087	3,314
Operating Profit	(115)	829	1,831	2,995
Profit After Tax	(1,211)	(155)	1,020	1,284
RATIO ANALYSIS				
Gross Margin (%)	0.4%	10.2%	14.8%	17.5%
Net Margin	-12.8%	-1.6%	7.2%	6.8%
Net Working Capital	(2,731)	(2,872)	(181)	-94162%
Trade debts/Sales	1%	1%	1%	1%
FFO	(988)	204	1,426	2,028
FFO to Total Debt (%)	-10%	2%	18%	19%
FFO to Long Term Debt (%)	-18%	4%	27%	38%
Current Ratio (x)	0.60	0.61	0.97	0.87
Debt Servicing Coverage Ratio (x)	0.14	1.25	1.76	3.13
Gearing (x)	3.92	4.27	1.41	1.51
ROAA (%)	-8%	-1%	6%	7%
ROAE (%)	-56%	-7%	26%	21%

ISSUE/ISSUER RATING SCALE & DEFINITION — 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	Aisha Steel Mills 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				
October 2, 2018	A-	A-2	Stable	Reaffirmed
October 5, 2017	A-	A-2	Stable	Initial