RATING REPORT

Aisha Steel Mills Limited

REPORT DATE:
October 31, 2019

RATING ANALYSTS:
Talha Iqbal
talha.iqbal@vis.com.pk

Asfia Aziz
asfia.aziz@vis.com.pk

RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	A-/A-2	A-/A-2
Rating Date	*October 31, 2019*	*October 02, 2018*
Rating Outlook	*Negative*	*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, 2019 (with stake 5% or more):	**Chief Executive Officer:** Dr. Munir Ahmed
Muhammad Arif Habib – 19.61%	
Arif Habib Equity (Pvt.) Ltd – 34.18%	
Arif Habib Corporation – 11.53%	

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

Aisha Steel Mills Limited (ASL)

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 65.35% in ASL as on June 30, 2019.

The board is chaired by Mr. 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 24 years of experience in the steel industry. Dr. Munir holds a PHD in Metallurgy and Material Engineering.

RATING RATIONALE

Challenging industry dynamics and high 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 1.7m MT (FY18: 1.22m MT, FY17: 0.77m MT). Overall demand of flat steel products witnessed attrition of 4% to 1.23m MT during FY19 on the back of weak macroeconomic environment and slowdown in GDP growth. Around 56% of the total flat steel demand comprises Cold Rolled Coils (CRC) with the remaining comprising Hot Dipped Galvanized Coils (HDGC). ASL and ISL cater to the majority of the flat steel demand (around 60%) while the remaining was met through imports in FY19. Within flat steel products, sales of CRC increased by 6%, while sales of HDGC declined by 15%. CRC imports surged by 23% during FY19 primarily from Russia but also from China. Despite imposition of Anti-Dumping Duties (ADD) on imports from China and Ukraine, dumping continued due to legal challenges in enforcement of ADD in various high courts.

Flat Steel Industry	FY18	%	FY19	%
CRC Sales (MT)				
ASL	217,045	33%	178,441	26%
ISL	194,000	30%	217,500	31%
Imports	240,000	37%	296,000	43%
Sub-total	**651,045**		**691,941**	
HDGC Sales (MT)				
ASL	-	0%	27,017	5%
ISL	346,000	54%	307,500	57%
Imports	290,000	46%	206,000	38%
Sub-total	**636,000**		**540,517**	
Total Flat Steel				
ASL	217,045	17%	205,458	17%
ISL	540,000	42%	525,000	43%
Imports	530,000	41%	502,000	41%
TOTAL	**1,287,045**		**1,232,458**	

VIS considers flat steels sector to comprise high business risk given the significant volatility in HRC- CRC margins and threat of dumping. This along with weak demand dynamics expected to persist during FY20 and increased competition post capacity expansion by both players is expected to impact pricing power and profitability of the sector. However, both local players expect sales to be supported by decline in imports due to improvement in implementation of ADD and imposition of preliminary ADD on flat steel imports from Russia (majority of imports in FY19 emanated from Russia) and Canada effective from 20th September 2019. While overall demand is expected to continue to slow down in FY20, ASL and ISL expect volumes to increase due to lower imports. Synchronization of demand with increased supply and decline in quantum of imports is considered important, going forward.

Satisfactory operating performance

The current production capacity of ASL is 700,000 MT; around 450,000 is CRC capacity while around 250,000 is HDGC capacity. Capacity utilization of CRC on the basis of available capacity stood at 92% (FY18: 99%) during FY19. The company also produced lower quantity of CRC in FY19 owing to production of galvanized coils in the last quarter. Addition of galvanizing line has diversified sales mix and is projected to be the key growth driver for the company.

Profitability witnessed pressure in FY19 due to decline in margins and sizeable finance cost. Achieving projected volumetric sales and enhancement in margins is important (amidst significant increase expected in finance cost) for improving profitability profile

Despite decline in quantity sold, sales revenue of the company increased by 7% during FY19 due to increase in average selling prices. A change in sales mix of the company was noted in the outgoing year with around 15% of the sales revenue being contributed by HDGC. Going forward, management envisages improvement in topline due to higher market share in HDGC segment and capturing of market share from imports. Proportion of HDGC in overall revenues is expected to increase to over 40% of total revenues in FY20.

Gross profitability of the company witnessed significant weakening largely on account of lower prime margins (HRC-CRC margins) due to fluctuation in exchange rate and volatility in international steel prices. The HRC prices gradually declined from US$ 570 per ton to US$ 480 FOB China during 1HFY19, a decline of about 16%. However, the prices recovered to US$ 525, FOB China during 2HFY19. Resultantly, gross margins of the company decreased to 8.3% (FY18: 17.5%) during FY19. Given lower margins and higher finance cost (due to increase in interest rate and higher borrowings), ASL incurred a loss before tax during the outgoing year. Going forward, VIS believes that topline and gross margins are expected to improve from current levels. However, overall profitability is projected to remain under pressure due to sizeable finance cost. Achieving projected volumetric sales and enhancement in margins is important (amidst significant increase expected in finance cost) for improving profitability profile.

Leverage indicators are expected to continue to remain elevated over the rating horizon

Equity base of the company slightly increased to Rs. 7.3b (FY18: Rs. 6.9b) at end-FY19. However, gearing levels increased significantly on account of higher utilization of short term borrowings and long term debt draw-down for expansion. Consequently, gearing and leverage indicators at end-FY19 were reported at 3.02x (FY18: 1.51x) and 3.31x (FY18: 1.72x), respectively. Adjusting for unsecured sponsor loan, gearing ratio stood at around 2.5x as at end June 2019. Stock in trade and trade debt coverage of short term borrowing further declined at end-June'2019. Even after adjusting for unsecured short-term loan, stock in trade and trade debts are lower than short-term borrowings. The management plans to bridge this mismatch through partial conversion of short term debt to long term facility. Given decline in debt levels (due to lower working capital requirements) and growth in equity base through profit retention, leverage indicators are expected to improve over the rating horizon.

Liquidity profile has room for improvement

Liquidity profile of the company is currently constrained given low coverage of outstanding debt and mismatch on balance sheet. FFO to Total Debt and FFO to Long Term Debt were reported at 3% (FY18: 19%) and 9% (FY18: 38%), respectively. Debt servicing coverage ratio was reported at 1.16x (FY18: 3.13x) during FY19. Going forward, significant volumetric growth in sales is expected to support cash flows and improve coverages. Current ratio of the company has remained below 1(x) and was reported at 0.67x (FY18: 0.87x) at end-FY19.

Aisha Steel Mills Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**
Fixed Assets	9,996	9,689	10,543	13,374	20,133
Deferred Tax Asset	1,110	1,134	1,358	933	1,344
Stock-in-Trade	2,434	2,814	3,716	4,312	6,920
Trade Debts	76	77	152	105	599
Cash & Bank Balances	132	45	861	46	209
Total Assets	15,337	15,353	18,184	20,426	32,731
Trade and Other Payables	2,744	2,773	3,561	1,210	1,234
Long Term Debt	5,618	5,827	5,289	5,390	7,720
Short Term Debt	3,876	3,870	2,435	5,045	14,112
Total Debt	9,494	9,697	7,724	10,435	21,832
Paid Up Capital (Ordinary Shares)	2,711	2,717	6,856	8,323	7,655
Total Equity	2,420	2,273	5,476	6,933	7,235
INCOME STATEMENT					
Net Sales	9,492	9,634	14,076	18,904	20,231
Gross Profit	41	980	2,087	3,314	1,678
Operating Profit	(115)	829	1,831	2,995	1,453
Profit Before Tax	(1,488)	(192)	882	1,916	(412)
Profit After Tax	(1,211)	(155)	1,020	1,284	254
RATIO ANALYSIS					
Gross Margin (%)	0.4%	10.2%	14.8%	17.5%	8.3%
Net Margin	-12.8%	-1.6%	7.2%	6.8%	1.3%
Net Working Capital	(2,731)	(2,872)	(181)	(942)	(5,547)
Trade debts/Sales	1%	1%	1%	1%	3%
FFO	(988)	204	1,426	2,028	708
FFO to Total Debt (%)	-10%	2%	18%	19%	3%
FFO to Long Term Debt (%)	-18%	4%	27%	38%	9%
Current Ratio (x)	0.60	0.61	0.97	0.87	0.67
Debt Servicing Coverage Ratio (x)	0.14	1.25	1.76	3.13	1.16
Gearing (x)	3.92	4.27	1.41	1.51	3.02
Leverage (x)	5.18	5.59	2.10	1.72	3.31
Stock+Trade Debts/STB	65%	75%	159%	88%	53%
ROAA (%)	-8%	-1%	6%	7%	1%
ROAE (%)	-56%	-7%	26%	21%	4%

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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	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 31, 2019	A-	A-2	Negative	Maintained
October 2, 2018	A-	A-2	Stable	Reaffirmed
October 5, 2017	A-	A-2	Stable	Initial