RATING REPORT

Aisha Steel Mills Limited

REPORT DATE:
March 10, 2022

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	A-/A-2	A-/A-2
Rating Date	*March 10, 2022*	*January 15, 2021*
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, 2021 (with stake 5% or more):	**Chief Executive Officer:** Dr. Munir Ahmed
Arif Habib Equity (Pvt.) Ltd – 33.91%	
Mr. Arif Habib – 20.75%	
Arif Habib Corporation – 8.01%	
Jubilee Life Insurance Company Limited – 7.99%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (August, 2021)   ***CorporateMethodology202108.pdf (vis.com.pk)***

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 has an annual capacity of 730,000 MT including CRC and HDGC.

ASML produces Cold Rolled Coils (CRC) and Galvanized Iron (GI) of international quality standards from imported Hot Rolled Coils (HRC). Company's products are used in automotive, construction, and engineering sectors as a premier raw material for further processing into a wide variety of value-added products.

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.

RATING RATIONALE

Aisha Steel Mills Limited, incorporated in 2005, is one of the two major producers of flat steel products in the country. At present, the company has the production capacity of 730,000 MT per annum. This is divided into 450,000 MT for Cold Rolled Coils (CRC) and 280,000 for Hot Dipped Galvanized Coils (HGDC). Capacity utilization levels showed noticeable improvement in FY21 due to favorable demand dynamics led by overall economic recovery, as COVID-19 induced restriction were gradually lifted.

As per management, the company is undertaking a project to enhance operational efficiency and raise production capacity. It is expected to be finalized in two years' time, after which the overall installed capacity will go up to 850,000 MT per annum. The plan has a total cost of Rs. 3.2b out of which Rs.2b will be financed by debt.

Operating Data	FY18	FY19	FY20	FY21
CRC Capacity (MT) (At Year End)	220,000	450,000	450,000	450,000
CRC Production (MT)	217,370	202,168	277,800	365,275
Capacity Utilization (CRC)	*99%*	*45%*	*62%*	*81%*
CRC Sales (MT)	**217,045**	**178,441**	**146,144**	**199,944**
Galvanized Iron Capacity (MT)		280,000	280,000	280,000
Galvanized Iron Production (MT)		33,223	121,137	169,478
Capacity Utilization (Galvanized)		*12%*	*43%*	*61%*
Galvanized Iron Sales Sales (MT)	**23,034**	**27,017**	**112,309**	**179,678**
Capacity Utilization (Total)	*99%*	*32%*	*55%*	*73%*

Industry Overview – Flat Steel

- Flat steel industry's offtake in FY21 depicted strong growth, following contraction posted in FY20. Given pandemic-induced lockdowns in Q4'FY20, the FY21 opened with a strong quarter wherein there was an element of pent up demand, while a stimulus package laden with incentives for construction industry also helped prop up the offtake during the year; accordingly, two listed flat steel companies, International Steels Limited (ISL) and Aisha Steel Mills Limited (ASL) posted 17.6% and 46.9% increase in volumetric offtake respectively. Nevertheless, full volumetric offtake for FY21 remained 25% lower than the high posted in FY18.

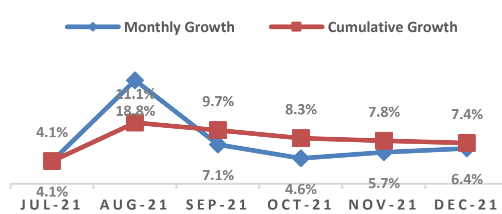
Table 1: Sales & Profitability Margins – Flat Steel Players

	ISL		ASL	
	FY20	**FY21**	**FY20**	**FY21**
Sales (In PKR' Billions)	48,082	69,796	29,777	55,116
Gross Margin	8.8%	19.3%	7.9%	20.3%
Net Margin	1.0%	10.7%	-2.1%	11.6%

Munir Ahmed who has 24 years of experience in the steel industry. Dr. Munir holds a PHD in Metallurgy and Material Engineering.

- In the global markets, expansionary policies drove the commodity markets in a strong bull momentum, with HRC pricing, which stood at USD 450/MT at beginning of FY21, shooting to USD 1,100/MT by end-FY21. Subsequently, the prices have receded to the range of USD 800-850/MT (China HRC FOB).
- As noted in other sectors, the bullish trend in HRC pricing, in combination with PKR depreciation, translated positively on the gross margins of market participants, as price increases were gradually passed on to end consumers and inventory gains were booked. With easing in HRC prices in H1'FY22, gross margin of market participants has started to normalize. Nevertheless, margins in H1'FY22 remained slightly elevated owing to continuing PKR depreciation, which stood at 11.8% for the period.
- As illustrated in Figure 1, the share of imports in the past couple years has notably reduced from 44% in FY19 to 27% in FY21. This is partly attributable to increased freight shipping charges and turnaround time.
- In Finance Bill 2021-22, the concessionary regime of SRO 565 no longer applies to re-rollers, who are now included in 5% Regulatory Duty in addition to the existing 5% custom duty. Accordingly, this is likely to restrict the supply of pipe mills, opening up a new segment for flat steel market participants.
- Furthermore, the Government of China has recently withdrawn the export rebate given to all exporters of CRC and GI, which should make local supplies more competitive.
- Recently in February 2022, the National Tariff Commission (NTC) has imposed anti-dumping duties ranging from 6.2%-17.3% on certain steel products, including iron or non-alloy steel, rolled coils or sheets, which were being imported and dumped from Taipei, EU, South Korea and Vietnam. The move should further have a positive demand impact on ISL and ASL.
- Under revised LSMI published by PBS the output of LSMI increased by 7.4% in H1'FY22, being revised from 3.4% under old methodology. The cumulative MoM change in LSMI depicted a slowdown in December 2021, being the 4th consecutive month showing the trend, following strong cumulative growth of 11.1% in August 2021.

Figure 1: Large Scale Manufacturing Index



- The production in FY22 vis-à-vis FY21 was higher in all elated industries, such as Iron and Steel Products, fabricated Metal. Machinery & Equipment and Automobiles, while it was lower for the Electronics industry.
- Our long-term demand outlook for steel products remains positive, given Pakistan's low existing steel consumption per capita. Nevertheless, short to medium term outlook is moderate with depressing factors being, a) potential slowdown in downstream industries like

construction and automobiles - likely to emanate from restrictions on car financing and tightening in monetary policy and b) prevailing inflation, which is likely to impact the buying power of end-consumers.

Increasing market share on a timeline basis.

To gain competitive advantage, the management took certain quality improvising initiatives in the outgoing year. Furthermore, additional emphasis was placed on direct communication with customers to better understand their needs and deliver them tailor-made products. To achieve the same and enhance overall market presence, new offices in Multan and Rawalpindi were established in the preceding year.

A significant growth in topline on the back of macroeconomic recovery. Inventory gains and exchange gains in FY21 translated into higher profitability.

Revenue for FY21 went up by 85% (FY20: Rs. 29.8b, FY19: Rs. 20.2b) and was reported at Rs.55.1b. this was achieved by a 47% volumetric growth and a 26% rise in average selling price. The higher demand is attributable to a resumption of economic activities during the year, which had slowed down due to the restrictions imposed by the government to deal with COVID-19. This was further supported by the construction sector package introduced by the government and the fulfillment of pent-up demand for automobiles. The entity was able to sustain the growth momentum in revenue in 1HFY22 with a reported figure of Rs. 31.6b. Sales volume are expected to remain relatively low in FY22 due to a slowdown in construction activities led by tightening of monetary policy escalating cost of production. However, long-term view on the sector demand is considered positive.

Company's margins also showed noticeable improvement in line with revenues. Gross margin and net margin for FY21 were reported at 20.3% (FY20: 7.9%, FY19: 8.3%) and 11.6% (FY20: -2.1%, FY19: 1.3%), respectively. Major contributors for the substantial improvement include inventory gains, exchange gains (Rs. 393m), higher returns on saving accounts (Rs. 26.5m) and lower finance cost (Rs. 1.5b in FY21 against Rs. 3.4b in FY20). Margins experienced a significant dip in 1HFY22 though, because of the decline in HRC price in the international market resulting in inventory and exchange losses along with greater finance burden (Rs. 1.6b). Improvement in profitability profile to commensurate with the assigned ratings is considered important.

Improving liquidity profile in FY21. Liquidity markers under pressure in 1HFY22

Liquidity indicators of the company strengthened in the outgoing year due to higher profits and reduced quantum of outstanding obligations. However the same witnessed pressure at end-Dec'21 with FFO to Total Debt and FFO to Long-term Debt reported at 3% (FY21: 63%, FY20: -4%) and 13% (FY21: 120%, FY20: -9%), respectively. Coverage of short-term borrowings against stock and trade debts reduced at end-Dec'21 to 99% (FY21: 192%). Going forward, ASL plans to raise further debt to finance its expansion plan, which may impact debt servicing ability and cash flow coverages. In lieu of the same, strengthening cash flow coverages going forward will be important to maintain assigned ratings.

Improvement in capital structure during FY21 due to a substantial increase in equity base. Elevated leverage indicators at end-Dec'21.

Led by profit retention in FY21, equity base of the company almost doubled and went up to Rs. 13.0b (FY20: 6.7b, FY19: Rs. 7.2b) plunging leverage indicators at period end. However, to finance inventory requirement in 1HFY22, quantum of short-term debt rose by Rs. 15.3b rising leverage and gearing ratios to 2.72x (FY21: 1.69x, FY20: 2.91x) and 2.43x (FY21: 1.11x, FY20: 3.97x), respectively at end-Dec'21. Leverage indicators were further affected by decline in equity base owing to dividend amounting Rs. 1.5b. Although dividend on cumulative preference shares were converted into ordinary shares increasing paid-up capital of the company. Given management's plans to raise additional long-term debt to the tune of Rs. 2b to finance the capacity and efficiency enhancement project, capitalization indicators are expected to increase. Improving capitalization profile under the current industry pressure is considered important.

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**HY22**
Fixed Assets	13,374	20,133	19,007	19,399	18,959
Deferred Tax Asset	933	1,344	2,159	449	529
Stock-in-Trade	4,312	6,920	7,916	12,088	20,904
Trade Debts	105	599	163	970	1,063
Cash & Bank Balances	46	209	183	238	305
Total Assets	20,426	32,731	34,509	36,524	45,954
Trade and Other Payables	1,210	1,234	6,293	6,938	2,712
Long Term Debt	5,390	7,720	9,410	7,701	7,070
Short Term Debt	5,045	14,112	9,946	6,796	22,114
Total Debt	10,435	21,832	19,357	14,497	29,184
Paid Up Capital (Ordinary Shares)	8,323	7,655	7,655	7,717	9,248
Total Equity	6,933	7,235	6,652	13,062	11,990
INCOME STATEMENT					
Net Sales	18,904	20,231	29,777	55,116	31,581
Gross Profit	3,314	1,678	2,366	11,185	2,660
Operating Profit	2,995	1,453	2,043	10,112	2,224
Profit Before Tax	1,916	(412)	(1,343)	8,588	591
Profit After Tax	1,284	254	(617)	6,368	452
RATIO ANALYSIS					
Gross Margin (%)	17.5%	8.3%	7.9%	20.3%	8.4%
Net Margin	6.8%	1.3%	-2.1%	11.6%	1.4%
Net Working Capital	(942)	(5,547)	(3,661)	789	(393)
Trade debts/Sales	1%	3%	1%	2%	2%
FFO	2,028	708	(850)	9,204	457
FFO to Total Debt (%)	19%	3%	-4%	63%	3%
FFO to Long Term Debt (%)	38%	9%	-9%	120%	13%
Current Ratio (x)	0.87	0.67	0.78	1.05	0.99
Debt Servicing Coverage Ratio (x)	4.48	1.17	0.62	6.71	0.79
Gearing (x)	1.51	3.02	2.91	1.11	2.43
Leverage (x)	1.72	3.31	3.97	1.69	2.72
Stock+Trade Debts/STB	88%	53%	81%	192%	99%
ROAA (%)		1%	-2%	18%	1%
ROAE (%)		4%	-9%	65%	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 below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
March 10, 2022	A-	A-2	Stable	Reaffirmed
January 15, 2021	A-	A-2	Stable	Maintained
October 31, 2019	A-	A-2	Negative	Maintained
October 2, 2018	A-	A-2	Stable	Reaffirmed

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.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Umair Noor	CFO	February 21, 2022
Mr. Khawar Ahsan Siddiqui	Director Sales & Marketing	February 21, 2022