RATING REPORT

International Steels Limited

REPORT DATE:
January 18, 2017

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A+	A-1
Rating Outlook	Stable	
Rating Date	*January 13, 2017*	

COMPANY INFORMATION	
Incorporated in 2007	External auditors: **KPMG, Taseer Hadi & Co, Chartered Accountants**
Public Limited Company	Chairman of the Board: **Mr. Kemal Shoaib**
Key Shareholders (with stake 5% or more):	Chief Executive Officer: **Mr. Yousuf H. Mirza**
International Industries Ltd – 56.3%	
Sumitomo Corporation – 9.1%	

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

International Steels Limited (ISL)

OVERVIEW OF THE INSTITUTION

International Steels Limited (ISL) was incorporated in 2007 and is currently Pakistan's premium producer of flat steel products with an annual production capacity of 550,000 tons. The company commenced operations in January, 2011, with primary business activity of the company involving manufacturing of cold rolled steel and galvanized coils.

Major shareholder of the company is International Industries Ltd. (IIL) with a 56.3% shareholding in ISL. The remaining shareholding is held by Strategic Investors (The International Finance Corporation and Sumitomo Corporation which collectively hold 13.7% of the shareholding) Foreign Corporate Investors, Financial Institutions and General Public (13.03%).

RATING RATIONALE

International Steels Limited (ISL) is the largest Cold Rolling Mill in Pakistan and is involved in the business of manufacturing cold rolled coils (CRC). During FY16, ISL modified its twin stand cold rolling mill which increased cold rolling capacity from 250,000MT to 550,000MT. Addition of a second galvanizing line has also increased galvanizing capacity from 150,000MT to 400,000MT while first ever color coating line in Pakistan was also completed with a capacity of 84,000MT. Capacity utilization was 95% and 67% during FY15 and FY16 (post capacity enhancement), respectively and is expected to increase in FY17.

Total demand for CRC in Pakistan is estimated at 1 million tons per annum, of which, around 55% is catered through by the two local manufacturers and the remaining is met through imports. Even if the operations of both local producers reach full capacity, the country will remain net importer of CRC. Competitive advantage for local CRC manufacturers stems from a 5% duty advantage as compared to importers.

ISL's current production mix comprises Cold-Rolled Product, Hot Dipped Galvanized Steel (HDGS) and Color Coated Steel, which are offered in coil or sheet form. The company has made arrangement with a geographically diversified network of distributors who sell ISL's products. In-house co-generation plant is a competitive advantage for ISL; installed capacity of the plant is 19MW and is sufficient to cater to the power related needs of the company. Excess power generated is sold to K-Electric Limited.

Market Position

The assigned ratings incorporate the company's position as the largest CRC and only HDGS manufacturer in the country. Moreover, the extensive experience and track record of sponsors in the steel sector is also a key rating driver.

Business Risk

Steel sector is characterized by high business risk given the cyclical nature of the industry, volatility in steel prices and threat of dumping particularly from China. Increase in import of CRC under mis-represented products and smuggling from Iran and Afghanistan also pose business risk. However, current low per capita steel consumption and favorable demand outlook from industries catered to by ISL is expected to contribute positively to sales. While threat of Chinese imports remains sizeable, expansion in capacity, duty benefit vis-à-vis importers, along with ISL's strategy of keeping margins at competitive levels has facilitated in partly mitigating competition from imports. Application for imposition of anti-dumping duties on cold roll and galvanized coils is also under consideration by National Tariff Commission.

Profitability

In line with higher production, sales volume witnessed healthy growth of 52% during FY16. The company also exports to various markets with export sales representing around one-tenth of total sales. Gross margins of ISL improved to 14% (FY15: 8%) during FY16 primarily on account of inventory gains and higher production which resulted in better absorption of fixed costs (lower cost per ton). With raw materials representing a major cost component and significant volatility in prices, efficient procurement, inventory management and volumetric off-take are critical to gross margins. Higher volumetric off-take, improved gross margins and lower financial charges have resulted in a significant jump in ISL's profitability. Going forward, improvement in profitability is expected to remain a function of higher volumetric off-take, trend in HRC and CRC prices and reduction in finance cost (lower borrowings).

Liquidity and Capitalization

Liquidity profile draws support from healthy cash flows in relation to outstanding obligations, improving working capital cycle and ageing profile of trade debts. ISL's working capital cycle, on account of availability of usance LC, is an advantage for the company given that payment for raw materials procured has to be made in 90 days while conversion of inventory into cash takes one-third of this period. Given the improvement in cash flows and accounting for planned capex, debt servicing and gearing is expected to remain at manageable levels. With an increase in equity base and decline in borrowings, leverage indicators have trended downwards. At end-1Q17, gearing declined to 1.21x (FY16: 1.34x & FY15: 2.14x).

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 Steels Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	30-June-16	30-June-15	30-June-14
Fixed Assets	12,620	12,332	9,772
Stock-in-Trade	5,314	4,438	3,667
Trade Debts	521	362	1,186
Cash & Bank Balances	38	38	37
Total Assets	20,984	19,075	16,879
Trade and Other Payables	4,695	2,280	1,956
Long Term Debt *(*incl. current maturity)*	4,744	6,591	3,751
Short Term Debt	3,524	4,069	4,876
Tier-1 Equity	6,168	4,978	5,206
Total Equity	7,143	5,530	5,770
INCOME STATEMENT	**30-June-16**	**30-June-15**	**30-June-14**
Net Sales	20,499	17,938	21,291
Gross Profit	2,913	1,485	2,248
Operating Profit	2,545	1,150	1,970
Profit After Tax	1,179	202	690
RATIO ANALYSIS	**30-June-16**	**30-June-15**	**30-June-14**
Gross Margin (%)	14%	8%	11%
Net Working Capital	(598)	(670)	(625)
FFO to Total Debt (x)	0.23	0.05	0.12
FFO to Long Term Debt (x)	0.4	0.08	0.27
Debt Servicing Coverage Ratio (x)	1.61	0.89	1.13
ROAA (%)	5.9%	1.1%	4.4%
ROAE (%)	21.2%	4%	14.2%

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 Steels 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.
Probability of Default	JCR-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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
13-Jan-17	A+	A-1	Stable	Initial