RATING REPORT

International Steels Limited

REPORT DATE:
April 05, 2018

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A+/A-1**	**A+/A-1**
Rating Date	*April 04, 2018*	*January 13, 2017*
Rating Outlook	Stable	Stable
Outlook Date	*April 04, 2018*	*January 13, 2017*

COMPANY INFORMATION	
Incorporated in 2007	**External auditors:** KPMG Taseer Hadi & Co.
Public Limited Company	**Chairman of the Board:** Mr. Kemal Shoaib
Key Shareholders: - International Industries Limited- 56.3% - Sumitomo Corporation- 9.1% - JFE Steel Corporation- 4.7%	**Chief Executive Officer:** Mr. Yousuf H. Mirza

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 550,000MT. The primary activity of the company is manufacturing of cold rolled steel coils (CRC), hot dipped galvanized coils (HDGC), and color coated coils.

Major shareholders of the company are International Industries Ltd. (IIL) and Sumitomo Corporation with a shareholding of 56.3% and 9.1% in ISL respectively. The remaining shareholders include directors, financial institutions, mutual funds, foreign companies, and general public.

The management team of ISL is spearheaded by Mr. Yousuf H. Mirza who is a qualified professional with relevant experience holding a BSc degree in mechanical Engineering from NED University of Technology and also has an MBA degree from the Institute of Business Administration.

RATING RATIONALE

The flat steel industry in Pakistan is a duopoly market and comprises two local producers International Steels Limited (ISL) and Aisha Steel Mills Limited (ASL). ISL imports Hot Rolled Coil (HRC) and converts it into Cold Rolled Coil (CRC), Galvanized (HDGC) and Color Coated sheet (PPGI). Total demand for flat steel products (Cold Rolled, Galvanized and Color Coated Sheet) in the country is estimated at around 1.2m MT and recorded a growth of 12% during FY17. Demand for flat steel products emanate from widespread usage and healthy demand outlook for industries catered to including automotive (motorcycle segment posted a growth of 20% during FY17), construction and white goods sector. Around two-third of the demand is currently being catered by the two local producers with remaining demand being met through imports. Imports of CRC have primarily been from China, Ukraine and Russia.

Material Developments

- In terms of installed capacity of local CRC industry, market share of ISL and ASL stands at 70% and 30%, respectively at end FY17. Given CRC industry's utilization levels of 86% during FY17 and a healthy demand outlook, both local players in the flat steel industry have announced capacity expansions. Resultantly, sector's cold rolling capacity is projected to increase to 1,700,000MT per annum from current levels of 770,000MT. Given the significant increase in capacity, utilization levels are expected to drop in the near term and are projected to revert to normal levels over the medium term. While focus of both players will continue to remain the local market, tapping export market in the near term will facilitate in utilization of excess capacities.
- Domestic companies had filed cases with the National Tariff Commission (NTC) for the imposition of antidumping duties (ADD) on cheaper influx of imports. To shield the domestic industry from dumping, NTC has imposed a definitive ADD in the range of 13-19% on CRC and in the range of 6-40% on imports of Galvanized Coil from China and Ukraine for a span of five years effective from Jan'2017 and Feb'2017, respectively. NTC recently announced on preliminary basis that significant increase in volume of dumped imports of color coated steel sheets was noted, but no ADD duty was imposed for the same. Final determination of the case remains pending.

ISL's Operations

Over the last three years, a key focus area of the management has been continuous enhancement and expansion of plant and machinery. The company enhanced its cold rolling capacity from 250,000MT to 550,000MT per annum in FY16 and increased its galvanizing capacity to 462,000MT per annum during the same period. During FY17, ISL undertook debottlenecking of pickling line and increased its annealing capacity. ISL's rolling and galvanizing capacity was reported at 550,000MT and 462,000MT, respectively at end-FY17 while utilization level significantly increased to 84% (FY16: 67%) and 68% (FY16: 55%) respectively during FY17. ISL is also in the process of expansion of its rolling mill almost doubling capacity to 1,000,000MT. The enhanced capacity is expected to come online in the ongoing fiscal year. In terms of product mix, the company continues to focus on higher value added segments where margins tend to be higher.

Business Risks

JCR-VIS considers flat steel sector to comprise high business risk given the significant volatility in HRC, CRC, HDGC margins and threat of dumping. This is also evident from significant volatility in quarterly gross margins of both players over the last 8 quarters. 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. Continuity of imposed duty and effective implementation of the same will be important rating sensitivities, going forward.

Sales and Profitability

Net sales revenue of the company was reported at Rs. 33.7b (FY16: Rs. 20.5b) during FY17, an increase of 65% as compared to the preceding year. Increase in sales was on account of a 35% volumetric growth while the remaining increase was a function of higher steel prices. Export sales represent around one-tenth of total sales. Gross margins of the company jumped to 17.5% (FY16: 14.2%) during FY17 on account of higher volumetric sales and improved pricing power due to favorable demand dynamics and imposition of anti-dumping duty. While risk of significant volatility in HRC, CRC & HDGC margins remains, management expects gross margins to sustain at current levels on account of continuous increase in production resulting in improved absorption of fixed cost (lower cost per MT). Given the higher turnover and margins, ISL's net profitability after tax witnessed a significant increase to Rs. 3b (FY16: 1.2b) during the outgoing year. With higher volumetric growth post increase in cold rolling capacity in ongoing fiscal year, profitability of the company is projected to continue to grow.

Liquidity and Capitalization

Liquidity profile of the company has significantly improved and is considered strong in view of healthy cash flows in relation to outstanding obligations with FFO to Total Debt reported at 55% (FY16: 23%) at end-FY17. Given the healthy cash flow from operations, debt servicing ability of the company is considered strong and was reported at 5.2x (FY16: 1.6x) at end-FY17. Current ratio of the company was reported at 1.00(x) at end-FY17 and end-1QFY18. Inventory days turnover was reported higher on account of significant purchases of raw material to avail applicable discount on the same.

Equity base of the company has grown at a CAGR of 13% over the past three years on account of internal capital generation. Dividend payout ratio of the company was recorded at 50% (FY16: 46%) during FY17. Over the last two years, ISL's gearing levels have improved but continue to remain on the higher side vis-à-vis peer companies. Given the additional borrowings planned to fund expansion plans and growth in equity due to retained profits, leverage indicators are projected to remain within benchmarks for the assigned ratings.

International Steels Limited (ISL) **Appendix I**

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY15	FY16	FY17
Fixed Assets	12,332	12,620	13,639
Stock-in-Trade	4,438	5,314	9,538
Trade Debts	362	521	764
Cash & Bank Balances	38	38	53
Total Assets	19,075	20,984	26,371
Trade and Other Payables	2,280	4,695	6,410
Long Term Debt	6,591	4,744	4,818
Short Term Debt	4,069	3,524	5,039
Total Equity	4,978	6,168	7,600
INCOME STATEMENT			
Net Sales	17,938	20,492	33,733
Gross Profit	1,485	2,906	5,906
Operating Profit	1,150	2,538	5,357
Profit After Tax	202	1,179	3,044
RATIO ANALYSIS			
Gross Margin (%)	8.3%	14.2%	17.5%
FFO to Total Debt (x)	0.05	0.23	0.55
FFO to Long Term Debt (x)	0.08	0.40	1.12
DSCR (x)	0.89	1.61	5.17
ROAA (%)	1%	6%	13%
ROAE (%)	4%	21%	44%

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				
04-Apr-18	A+	A-1	Stable	Reaffirmed
13-Jan-17	A+	A-1	Stable	Initial