RATING REPORT

International Steels Limited

REPORT DATE:
June 25, 2019

RATING ANALYST:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A+/A-1**	**A+/A-1**
Rating Date	*June 21, 2019*	*April 04, 2018*
Rating Outlook	Stable	Stable
Outlook Date	*June 21, 2019*	*April 04, 2018*

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

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria ***Corporates (May 2016)***
https://www.vis.com.pk/kc-meth.aspx

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 1,000,000MT. 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.

Profile of the CEO

Mr. Yousuf H. Mirza 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.

Financial Snapshot

Net Equity: FY18 – 11.8 b.

Net Profit: FY18 – Rs..4.3b

RATING RATIONALE

World steel scenario

In view of the growth in global economy in 2018, the steel industry benefitted from such momentum with world crude steel production increased to 1.73b Metric Tonnes (MT) (2017: 1.64b MT), depicting a growth of 5.48%. Major growth is contributed largely from the top 5 steel producing countries namely China, Japan, India, USA and Russia; China posted the highest growth of 11.5% for the same period under review.

Top 10 Crude Steel Producers

mn MT	2016	2017	2018
China	807.60	831.70	927.52
Japan	104.80	104.70	104.32
India	95.50	101.40	106.46
United States	78.50	81.60	86.61
Russia	70.50	71.30	71.68
South Korea	68.60	71.00	72.46
Germany	42.10	43.40	42.43
Turkey	33.20	37.50	37.31
Brazil	31.30	34.40	34.73
Italy	23.40	24.10	24.47

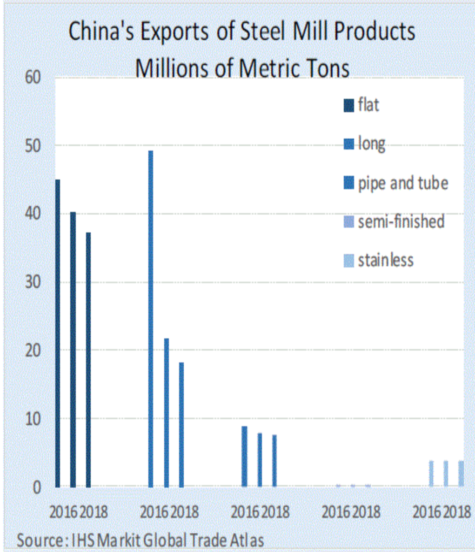
Steel Industry in China

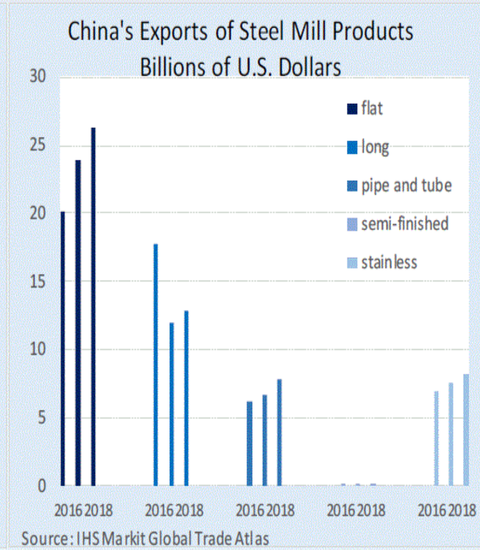
China enjoys the position of largest producer of steel in the global market. China's production stood at 927.52m MT of crude steel, on a standalone basis for 2018, out of which consumption and exports stood at 875.6m MT & 66.9m MT, respectively. China's exports largely comprise flat steel accounting for 56% (37.1m MT) of total turnover while long steel products accounted for 27% (18.3m MT), followed by pipe and tube products at 11% (7.6m MT), stainless steel at 6% (3.8m MT) and semi-finished steel at 0.02% (0.02m MT). On a timeline basis, China has faced a decline of 8.7% in flat steel from its major export markets; Vietnam, South Korea, and Philippines on account of imposition of anti-dumping duties along with countervailing duties on China by various countries. This volumetric reduction in exports resulted in surplus inventory for China amounting to 14.2m MT, at end-2018.

Table 2: China's Production & Consumption Statistics

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Production	577.1	638.7	702.0	731.0	822.0	822.8	798.8	808.4	831.7	928.3
Apparent Consumption	576.3	615.2	671.6	691.7	776.5	746.2	701.8	715.2	772.2	875.6
Exports	23.0	40.5	46.5	53.3	60.1	91.3	110.0	106.6	73.3	66.9
Export Share of Production	4.0%	6.3%	6.6%	7.3%	7.3%	11.1%	13.8%	13.2%	8.8%	7.2%

Source: U.S. Department of Commerce, World Steel Assocation, IHS Markit Global Trade Atlas





Moreover, value of exports for flat steel products increased given higher prices of HRC & CRC ranging between $600-$650 in 2018 vis-à-vis $450-$600 in 2017 along with the US-China trade war impacting international flat steel prices.

Local market

Local steel market comprises two players namely International Steel Limited (ISL) and Aisha Steel Limited (ASL). ISL operates at a total CRC capacity of 1,000,000 MT whereas ASL has a capacity of 220,000 MT. The local market size of CRC was 630,000 MT for FY18, growing at a rate of 7.15% on a year-on-year basis, on account of imposition of anti-dumping duties on China and Ukraine in the range of 13%-19%. As a result of partial import substitution, market shares of both ISL and ASL were reported at 45% and 16%, respectively. Overall market size increased by 7% owing to major increase in imports flowing in from Russia and South Korea.

CRC Sales (In MT)	FY16	FY17	FY18
ASL	181,259	214,313	186,000
ISL	124,010	190,629	194,000
Imports	359,000	183,000	250,000
Total CRC industry sales	**664,269**	**587,942**	**630,000**

Galvanized Coils Market

Currently, ISL is the only producer in Galvanized coils with an increased market share of 61% in FY18 from 47% in FY16. The local market witnessed a growth of 9.3% in FY18 in view of imposition of antidumping duties in the range of 6%-40% on China, a major producer of crude steel. Going forward, ASL is setting up its own galvanized coil plant in the near horizon.

HDGC Sales (In MT)	FY16	FY17	FY18
ASL	-	-	-
ISL	240,528	300,375	346,000
Imports	270,000	212,000	214,000
Total GI industry sales	**510,528**	**512,375**	**560,000**

Going forward, the overall market for flat steel will witness further capacity expansion by both players (ISL & ASL). ISL has expanded the cold rolling capacity which now stands at 1,000,000 MT (FY17: 550,000 MT); a significant increase providing impetus to the whole cold rolling strip. On the other hand, ASL has expanded the cold rolling capacity which now stands at 700,000 MT (FY18: 220,000 MT). Out of this expansion, the 230,000 MT will be added to CRC manufacturing, and the rest (250,000 MT) will be introduced in the galvanizing line. The sector expansions will increase the local supply to 1.7m MT by end of FY19, which currently stands at 1.22m MT.

Key Rating Drivers:

Production

ISL's current production mix comprises of 37% Cold-Rolled Product, 59% Hot Dipped Galvanized Steel (HDGS) and 4% Color Coated Steel offered in coil or sheet form. The company has made arrangements with a geographically diversified network of distributors who sell ISL's products. Its 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.

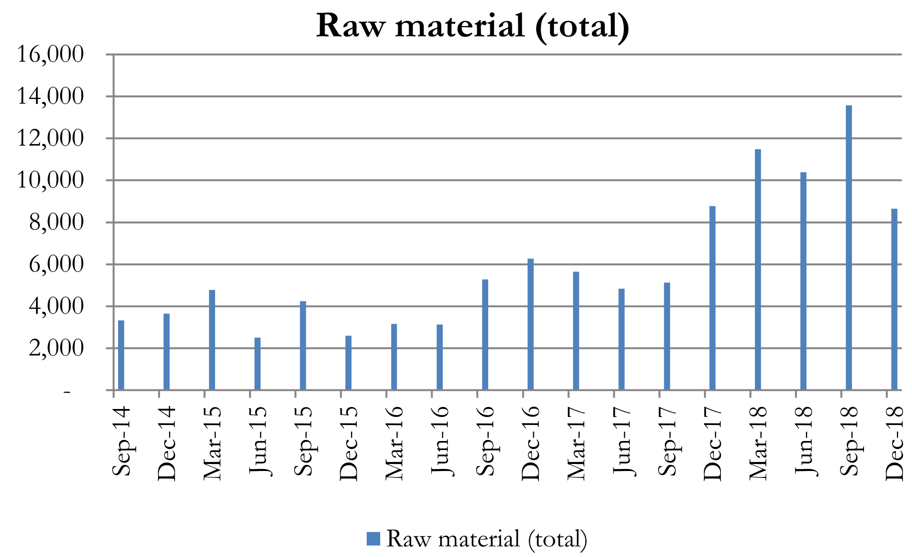
Sales

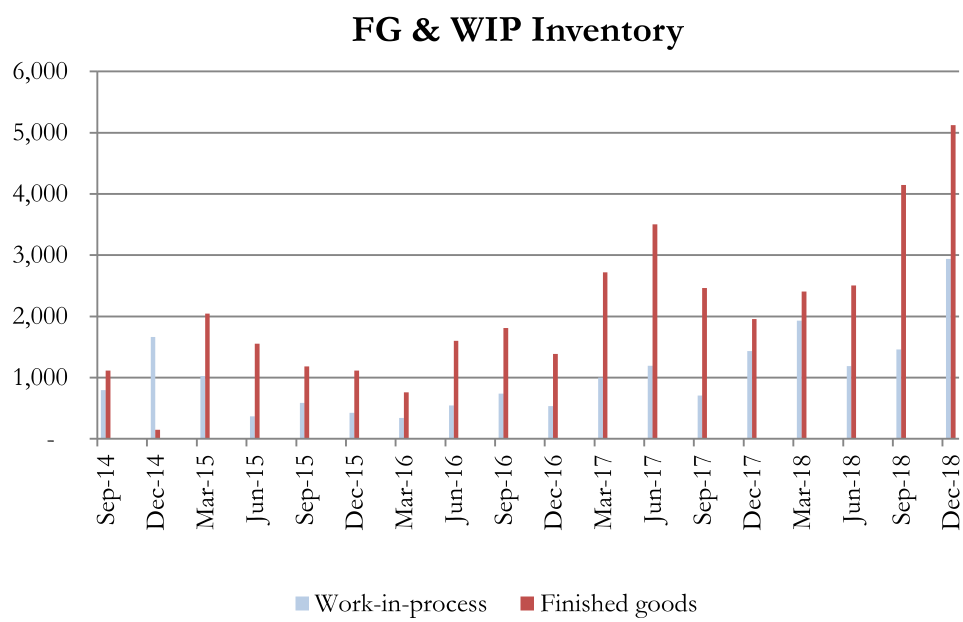
Sales of ISL amounted to Rs. 47.6b (FY17: Rs. 33.7b), posting a growth of 41%, contributed by both volume and price increases for FY18. The local sales comprise 92% of gross sales while the remaining pertains to export market for the same year under consideration. Total sales volume stood at 240,000 MT for 1HFY19 (1HFY18: 270,000 MT) posting a decline of 11% on yearly basis. However, value of sales increased by 12% on a year on year basis by end-1HFY19 owing to competitive pricing strategy. Gross margin of the company declined to 16% (FY17: 18%) for FY18; it declined further to 12.4% for 1HFY19 on account of significant decrease in CRC prices globally as compared to HRC prices shrinking the CRC-HRC margin to $80/ton (FY18: $86/ton). However, the management expects further decline in sales volume and the price concurrently due to influx of dumped and under invoiced import from China and Russia. As a result, ISL expects a reduction in the price owing to the underpriced imports which will further reduce their margins.

Operating cycle

Raw material inventory amounted to Rs. 8.64b (1QFY19: Rs. 13.5b, 4QFY18: Rs. 10.3b, 3QFY18: Rs. 11.4b, 2QFY18: Rs. 8.7b) at end-2QFY19. The elevated raw material inventory levels during the period are a result of the increased capacity of cold rolling strip. A similar trend is witnessed in the finished goods & WIP inventory which collectively amounted to Rs. 8.05b (1QFY19: Rs. 5.6b, 4QFY18: Rs. 3.6b, 3QFY18: Rs. 4.3b, 2QFY18: Rs. 3.3b) at end2QFY19. Stock in trade of ISL amounted to Rs. 16.9b at end-1HFY19 (FY18: Rs. 14.1b, FY17: Rs. 9.5b). This buildup of inventory reflects slowing of local demand in the sector and posts a drag on the profitability and liquidity of the company. ISL currently operates at an operating cycle of 117 days and cash cycle of 60 days, which necessitates the need for short term financing for working capital requirements. ISL has efficiently reduced its operating cycle to 117 days for FY18 (FY17: 132 days) given volumetric growth of sales of CRC & HDGC. On the other hand, the cash cycle remained same at 60 days with early payments made to raw material suppliers. These tight liquidity requirements necessitate short term borrowings.

Quarterly Analysis (Rs. in m)	FY17 (1Q)	FY17 (2Q)	FY17 (3Q)	FY17 (4Q)	FY18 (1Q)	FY18 (2Q)	FY18 (3Q)	FY18 (4Q)	FY19 (1Q)	FY19 (2Q)
Sales	6,586	8,635	9,562	8,950	10,708	11,482	12,628	12,803	11,232	13,549
Margins	16%	21%	18%	15%	17%	17%	16%	14%	14%	11%
Trade debts	530	729	731	764	916	307	766	645	397	334
Stock-in-trade	7,875	8,212	9,368	9,538	8,291	12,159	15,827	14,133	19,320	16,903
Short term debt	1,823	2,992	1,313	5,039	4,767	2,122	8,185	8,462	13,770	7,898





Capitalization and Funding

Asset base of the company stood at Rs. 39.5 b(FY18: 35.5b, FY17: 26b) at end-1HFY19, depicting growth on a timeline basis on account of capacity expansion and concurrent working capital investment. The overall project cost of the cold rolled strip amounted to Rs. 5.6b, which was partially financed by long term debt. Total debt of the company stood at Rs. 15.6b at end-1HFY19 (FY18: Rs. 16.4b, FY17: Rs. 9.8b), out of which long term debt stands at Rs. 7.7b and short term stood at Rs. 7.8b. ISL currently operates at a highly leveraged capital structure where gearing and leverage stand at 1.37x and 2.41x, respectively. Liquidity position of the company has further dampened owing to decrease in the sales and margins. As a result, FFO (Funds from operations) amounted to Rs. 2.3b at end 1HFY19 (FY18: Rs. 5.7b, FY17: Rs. 5.4b) translating FFO to total debt at 0.3x at end-1HFY19 (FY18: 0.35x, FY17: 0.55x). The coverage, going forward, is expected to decline on the back of low demand, margin pressure and higher interest expenses. Nonetheless, the company has a sizeable core equity base of Rs. 11.3b at end-1HFY19 (FY18: Rs. 10.8 b, FY17: Rs. 7.6 bn) which has grown by 21% on a yearly basis on account of internal capital generation. Dividend payout ratio of the company was recorded at 45% (FY17: 50%) during FY18.

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY15	FY16	FY17	FY18	1HFY19
PPE	12,332	12,620	13,639	18,263	18,986
Stock-in-Trade	4,438	5,314	9,538	14,133	16,903
Trade Debts	362	521	764	645	334
Cash & Bank Balances	38	38	53	100	364
Total Assets	19,075	20,984	26,371	35,593	39,568
Trade and Other Payables	2,280	4,695	6,410	5,471	8,469
Long Term Debt	6,591	4,744	4,818	7,970	7,713
Short Term Debt	4,069	3,524	5,039	8,462	7,898
Core Equity	4,978	6,168	7,600	10,883	11,336
Net Worth	5,530	7,143	8,554	11,825	12,268
INCOME STATEMENT					
Net Sales	17,938	20,492	33,733	47,621	24,781
Gross Profit	1,485	2,906	5,906	7,573	3,067
Admin Exp	168	161	215	285	135
Selling & Distribution	168	207	334	434	243
Profit After Tax	202	1,179	3,044	4,365	1,748
RATIO ANALYSIS					
Gross Margin (%)	8.3%	14.2%	17.5%	15.9%	12.4%
Net margin (%)	1.1%	5.8%	9.0%	9.2%	7.1%
FFO	559	1,915	5,412	5,737	4,607
FFO to Total Debt (x)	0.05	0.23	0.55	0.35	0.30
FFO to Long Term Debt (x)	0.08	0.40	1.12	0.72	0.60
DSCR (x)	0.89	1.61	5.17	3.75	2.97
Gearing (x)	2.14	1.34	1.30	1.51	1.38
Leverage(x)	2.72	2.24	2.34	2.18	2.41
ROAA (%)	1.1%	5.9%	12.9%	14.1%	9.3%
ROAE (%)	4.0%	21.2%	44.2%	47.2%	31.5%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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	International Steels Limited
Sector	Steel
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
21-Jun-19	A+	A-1	Stable	Reaffirmed
04-Apr-18	A+	A-1	Stable	Reaffirmed
13-Jan-17	A+	A-1	Stable	Initial

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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