RATING REPORT

International Steels Limited

REPORT DATE:
May 23, 2022

RATING ANALYST:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A+/A-1**	**A+/A-1**
Rating Date	*May 23, 2022*	*March 12, 2021*
Rating Outlook	*Stable*	*Stable*
Outlook Date	*May 23, 2022*	*March 12, 2021*

COMPANY INFORMATION	
Incorporated in 2007	**External auditors:** A.F. Ferguson & Co., Chartered Accountants
Public Limited Company	**Chairman:** Mr. Amjad Waheed
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 (August 2021)*   ***https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf***

International Steels Limited

OVERVIEW OF 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.

RATING RATIONALE

International Steels Limited ('ISL' or 'the Company') was incorporated in 2007 and is currently Pakistan's premium producer of flat steel products with an annual production capacity of 1m MTs. 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 include International Industries Ltd. (IIL) and Sumitomo Corporation with a shareholding of 56.3% and 9.1% respectively. ISL has in-house co-generation plant with an installed capacity of 19MW that is sufficient to cater to the power related needs of ISL, while excess power is sold to K-Electric Limited.

Industry Overview – Flat Steel

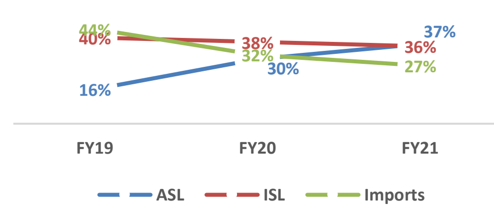
- Flat steel industry's offtake in FY21 depicted strong growth, following contraction posted in FY20. Given pandemic-induced lockdowns in Q4'FY20, the FY21 opened with a strong quarter wherein there was an element of pent up demand, while a stimulus package laden with incentives for construction industry 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%

- 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.

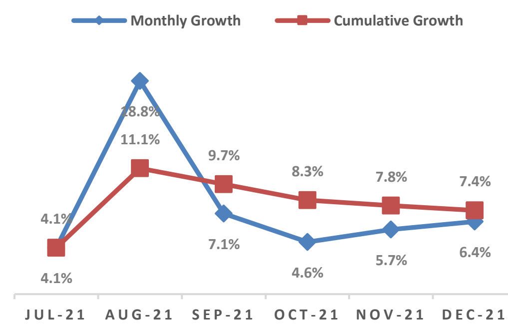
Figure 1: Flat Steel Industry Market Share



- 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 2: Large Scale Manufacturing Index



- The production in FY22 vis-à-vis FY21 was higher in all related 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.

Business Review – ISL

Table 2: Capacity Utilization

Capacity Utilization (ISL)	FY19	FY20	FY21
CRC			
Installed Capacity (MT)	1,000,000	1,000,000	1,000,000
Production (MT)	584,408	424,355	498,037
Utilization (%)	**58%**	**42%**	**50%**
HDGC			
Installed Capacity (MT)	462,000	462,000	462,000
Production (MT)	330,350	230,023	293,598
Utilization (%)	**72%**	**50%**	**64%**
Color Coated Coils			
Installed Capacity (MT)	84,000	84,000	84,000
Production (MT)	15,789	21,166	17,789
Utilization (%)	**19%**	**25%**	**21%**
Total production	930,547	675,544	809,424

- ISL is the largest flat steel market participant, in terms of both sales and capacities. Capacity under-utilization has remained a prevalent issue for both flat steel market participants. As illustrated in the table above, capacity utilization was notably affected in FY20, given the closures in Q4'FY20; nevertheless, production has since notably increased. In FY21 production was 19.4% higher than preceding year.
- Even though capacities remain adequate, the management has plans for capital expenditure to offer value-added services to customers and debottlenecking of existing facility.
  - In FY21, new Purlin machines were added to the Service Center catering to the needs of the construction sector.
  - An investment of Rs. 1.23b has been planned for a debottlenecking project to enhance the finishing capacity of CRC sheets by 120,000 MT per annum. This will be financed by financing under SBP's concessionary financing schemes (TERF & LTFF). New expansion will enable to company to strengthen foothold in the Engineering sector.
  - In June 2021, the management has concluded feasibility for setting up a hot rolled strip mill to meet the growing demands of flat steel market.

Table 3: P&L (Extract)

	FY19	FY20	FY21	H1'FY21	H1'FY22
Net sales (PKR million)	55,062	48,082	69,796	33,516	43,294
Gross Margin (%)	11.7%	8.8%	19.3%	14.8%	16.7%
Operating Margin (%)	9.0%	5.7%	15.9%	13.1%	14.4%
Net Margin (%)	4.8%	1.0%	10.7%	8.3%	9.8%

- Following 13% contraction in revenues in FY20, the revenue base rebounded strongly in FY21, posting growth of 45%. Majority (~60%) of the increase in revenue was a product of pricing increase, while remaining can be attributed to higher volumetric offtake.
- In volumetric terms, sales climbed by 17.6% in FY21, owing primarily to a 23% increase in HDGC sales and a 10% increase in CRC product.
- Export volumes has also risen by 11% in FY21, from 84,250 to 93,331 tons, while income increased by 32% to Rs. 11.9b, up from Rs. 9b the previous year.
- Revenue growth remained strong in H1'FY22, coming in at 19.2% higher than SPLY.
- ISL's gross margins depicted strong YoY increase, mainly precipitated by the bullish trend in steel prices and PKR depreciation, which translated in inventory gains for the Company. As HRC pricing has slightly eased in H1'FY22, margins have reduced. The net sales revenue for Q2'FY22 was 23% lower than Q1'FY22 and gross margin was also lower at 15.3% for Q2'FY22 vis-à-vis 17.7% for Q1'FY22.

- The Company's bottom line was notably higher in FY21, coming in at Rs. 7.5b vis-à-vis Rs. 495m in FY20. Growth in bottom line was a function of volumetric growth better gross margins and lower financial charges.
- Financial charges reduced by 65% to Rs. 812m from Rs. 2.3b, owing to lower cost of debt 7.3% (FY20: 11.3%)[1] and a stable exchange rate.

Table 4: Cash flow Analysis

	FY19	FY20	FY21	H1'FY22
FFO	3,876	1,025	10,874	5,416
FFO to Total Debt (x)	0.22	0.06	0.91	0.46*
FFO to Long Term Debt (x)	0.53	0.16	2.08	2.31*
Debt Servicing Coverage Ratio (x)	2.14	1.03	4.84	4.97*
Current Ratio (x)	1.09	0.94	1.38	1.20
Stock + Trade Debt/ STB	152.2%	140.2%	265.2%	180.7%
***Annualized**				

- In tandem with uptick in revenue base, FFO has also grown significantly by 9.6x in FY21; accordingly, cash flow coverage indicators have posted notable improvement.

Table 5: Cash Conversion Cycle

	FY20	FY21	H1'FY22
Cash Conversion Cycle	**84**	**42**	**31**
- Days Inventory Outstanding	134	78	129
- Days Receivable Outstanding	12	4	10
- Days Payable Outstanding	62	41	107

- The cash conversion cycle has notable receded since posting a high in FY20. ISL's cash conversion cycle mainly features sizable inventory days, with receivable days being minimal. As of Dec'21, the Company's stock of inventory and trade debts amounted to Rs. 32.2b and Rs. 1.7b respectively. Inventory level as of Dec'21, stood at its highest in comparison to last 10 quarters; it included Rs. 17.4b of raw material and work in process and Rs. 14.8b of finished goods.

Table 6: Balance Sheet (Extract)

	Jun'20	Jun'21	Dec'21
Total Assets (PKR million)	42,861	41,720	57,599
Total Liabilities (PKR million)	30,135	22,832	37,532
Total Equity (PKR million)	11,472	17,667	18,863
Total Debt (PKR million)	18,087	12,012	23,425
- **Long Term Debt (PKR million)**	6,566	5,216	4,681
- **Short Term Debt (PKR million)**	11,520	6,796	18,743
Leverage (x)	2.63	1.29	1.99
Gearing (x)	1.58	0.68	1.24

- Given strong profitability and adequate retention, the Company's equity has grown from Rs. 11.5b as of Jun'20 to Rs. 18.9b as of Dec'21.

- Given the strong growth in equity, the Company's gearing receded to 0.68x. Nevertheless, given increased working capital requirements in H1'FY22, gearing increased to 1.24x as of December 2021.

- The management has envisaged additional capital expenditure of Rs. 1.23b during the rating horizon. Gearing is likely to stay contained on the back of adequate profitability and retention.

Key Rating Drivers

Ratings incorporate long operational track record and market position of ISL as the market leader in the flat steel industry
The assigned ratings are underpinned by the Company's market leadership position in the flat steel segment, in terms of both sales and capacities. Established in 2007, ISL has operational track record of more than a decade in the industry.

Ratings are constrained by high business risk of flat steel segment
Ratings are constrained by high business risk of the flat steel industry, with raw material constituting majority of the product pricing. Accordingly profitability margins depict significant sensitivity to changes in HRC pricing and exchange rate volatility. In addition, the industry is also exposed to the threat of dumping, which is partly offset by anti-dumping duties.

Ratings incorporate the cash flow coverages and financial risk profile of ISL
The ratings incorporate the strong cash flow coverages and moderate gearing level of the Company, both of which are aligned with the rating assigned to ISL. In the outgoing year, cashflow coverages have notably improved on the back of superior profitability margins, which were driven by the bullish trend in HRC pricing; nevertheless, these are likely to normalize to long term trend of ISL, as the commodity cycle eases.

Ratings incorporate qualitative Corporate Governance infrastructure in place at ISL
ISL's assigned rating is supported by Corporate Governance infrastructure in place at ISL, which is strong given ISL's operational status as a listed entity.

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1 Average debt calculated on 5-point average basis

International Steels Limited

Appendix I

FINANCIAL SUMMARY				(amounts in PKR millions)
BALANCE SHEET	**Jun'19**	**Jun'20**	**Jun'21**	**Dec'21**
PPE	19,862	20,638	19,180	19,248
Stock-in-Trade	14,648	15,132	17,081	32,178
Trade Debts	868	1,016	940	1,689
Cash & Bank Balances	403	106	293	144
Total Assets	39,762	42,861	41,720	57,599
Trade and Other Payables	5,612	8,932	6,588	9,412
Long Term Debt	7,277	6,566	5,216	4,681
Short Term Debt	10,191	11,520	6,796	18,743
Total Debt	17,468	18,087	12,012	23,425
Paid-up Capital	4,350	4,350	4,350	4,350
Total Equity (excl. Surplus)	11,590	11,472	17,667	18,863
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**H1'FY22**
Net Sales	55,062	48,082	69,796	43,294
Gross Profit	6,449	4,213	13,492	7,211
Admin expense	284	263	362	165
Selling & Distribution	702	894	1,063	396
Profit Before Tax	3,679	442	10,295	5,672
Profit After Tax	2,664	495	7,466	4,224
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**H1'FY22**
Gross Margin (%)	11.7%	8.8%	19.3%	16.7%
Net margin (%)	4.8%	1.0%	10.7%	9.8%
FFO	3,876	1,025	10,874	5,416
FFO to Total Debt (x)	0.22	0.06	0.91	0.46*
FFO to Long Term Debt (x)	0.53	0.16	2.08	2.31*
DSCR (x)	2.14	1.03	4.84	4.97*
ROAA (%)	7.1%	1.2%	17.7%	17.0%*
ROAE (%)	23.7%	4.3%	51.2%	46.2%*
Leverage (x)	2.32	2.63	1.29	1.99
Gearing (x)	1.51	1.58	0.68	1.24
Current Ratio (x)	1.09	0.94	1.38	1.20
Stock+ Trade Debt/STB	152.2%	140.2%	265.2%	180.7%
***Annualized**				

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				
	23-May-22	A+	A-1	Stable	Reaffirmed
	12-Mar-21	A+	A-1	Stable	Maintained
	20-Oct-20	A+	A-1	Rating Watch-Negative	Maintained
	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.				
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 Meetings Conducted	**Name**	**Designation**	**Date**		
	Mr. Mujtaba Hussain	CFO	January 13, 2022		