

## RATING REPORT

### Agha Steel Industries Limited

**REPORT DATE:**

December 6, 2017

**RATING ANALYSTS:**

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#### RATING DETAILS

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A	A-1
Rating Outlook	Stable	
Rating Date	December 5, 2017	

#### COMPANY INFORMATION

Incorporated in 2013	External auditors: Haroon Zakaria and Company Chartered Accountants
	Chairman of the Board: Mr. Iqbal Hussain Agha
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. Hussain Iqbal Agha
Mr. Iqbal Hussain Agha	
Mr. Raza Iqbal Agha	
Mr. Hussain Iqbal Agha	
Ms. Shazia Iqbal Agha	

#### APPLICABLE METHODOLOGY(IES)

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

**Agha Steel Industries Limited**

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p>Agha Steel Industries Limited (ASIL) was incorporated in Pakistan on November 19, 2013 as a private limited company. On April 7, 2015 ASIL converted itself into a public limited company. The company’s core business relates to manufacturing steel, melting and re-rolling mills with the production plant situated at Port Qasim Karachi.</p> <p>The board comprises 7 members and is chaired by Mr. Iqbal Hussain Agha. Mr. Iqbal belongs to one of the leading industrial powerhouses in Pakistan. He possesses deep-rooted industrial experience across different industries, particularly in the steel and textile sectors. He has been involved in several successful ventures, including Abbas Steel Korangi, Abbas Textiles and Denim International.</p>	<p>Agha Steel Industries Limited (ASIL) is amongst the top-tier players in the long steel sector with installed capacity of billets and reinforcement bars (rebars) at 240,000MT and 150,000MT, respectively. Competitive advantage stems from the company being the only private sector manufacturer using Electric Arc Furnace for manufacturing of billets. ASIL’s capacity utilization level of bars stood at 91% (FY16: 85%) during FY17 and is highest amongst peers. In order to cater to rising demand, ASIL is in the process of expanding its capacity. The first phase includes BMR of existing facility which will increase melting capacity of billets and rolling capacity of rebars to 450,000MT and 250,000MT, respectively. The second phase of expansion will increase rolling capacity by 450,000MT. The BMR and new rolling mill are targeted to come online by March’2018 and September’2019, respectively.</p> <p><b><u>Sector Dynamics</u></b></p> <ul style="list-style-type: none"> <li>• Overall sectoral risk is considered high given the fragmented nature of the industry, expected increase in competition post capacity expansion by major players (Three of the major existing players are increasing their capacity by over 3(x)), cyclical nature of the industry and the threat of dumping particularly from China.</li> <li>• However, outlook for the sector has witnessed noticeable improvement on the back of robust demand due to investment in development of infrastructure &amp; power generation and increase in duty protection against imports from China.</li> <li>• Local players enjoy 24% and 30% regulatory duty protection on imported billets and rebars, respectively. Imposition of anti-dumping duty (ADD) on imported billets in June’2017 is expected to reduce competitiveness of non-integrated players while ADD of 19.15% imposed on Chinese imports of re-bars will further enhance competitive advantage vis-à-vis imports.</li> <li>• Higher demand and imposition of Regulatory Duty (RD) &amp; Anti-Dumping Duty (ADD) has improved pricing power of industry players. This has allowed companies to pass on impact of higher steel scrap prices which have witnessed a noticeable increase during 2017.</li> <li>• Moreover, expansion by top-tier players is expected to result in improved efficiencies and financial benefits due to increase in conversion yield (from billets to rebars) and lower power (lower KWH/ton power consumption), re-heating &amp; labor cost.</li> </ul> <p><b><u>Sales and Market Penetration</u></b></p> <p>During FY16 and FY17, volumetric sales of rebars have increased by 28% and 15%, respectively. As per management, sales outlook remains robust with 2 months orders in hand at all times. Corporate and institutional sales (builders and contractors) represents around three-fourth of total sales. ASIL’s market position is stronger in the Southern market with increased penetration planned in the Northern region. The same is considered important in the backdrop of sizeable capacities coming online. In addition, growth in retail sales will also be pursued for mitigating the likely adverse impact of concentration in sales. JCR-VIS expects growth in retail sales to materialize overtime.</p> <p><b><u>Profitability</u></b></p> <p>Profit before tax of the company has grown at 76% and 46% during FY16 and FY17, respectively. Increase in profitability is a function of improved volumetric off-take and higher gross margins which compare favorably to peers. Improvement in gross margins (FY17: 27%; FY16: 23%) is attributable to full year impact of decline in electricity cost and higher production.</p> <p><b><u>Cash Flows</u></b></p> <p>With increase in profitability, ASIL’s funds from operations (FFO) have significantly increased to Rs. 1.8b (FY16: Rs. 1.3b) in FY17. FFO in relation to outstanding obligations has witnessed noticeable improvement with debt servicing coverage being comfortable at 2.2(x). Given the increase in debt payments, cushion in debt servicing is expected to decline in FY19. The same is projected to increase again in FY20 with improvement in cash flows post expansion. Key risk to timely debt servicing include delay in planned expansion, increase in raw material &amp; power cost beyond levels that can be passed on to customers, slowdown in demand due to delays in execution of major infrastructure projects and adverse changes in duty structure resulting in increase in dumping from China. As per the management, the working capital cycle is relaxed with 4-6 months payment period against scrap coupled with</p>

credit terms on sales of 1-2 months. Short-term borrowings on the balance sheet are a function of over 2 months of scrap carried by ASIL and almost 1.5 months of finished products. Moreover, the same is being used to partly fund trade receivables which have increased in quantum. Future trend with respect to overdue receivables will continue to be tracked by JCR-VIS.

**Capitalization**

With a slight decline in debt levels and increase in equity base, leverage indicators have declined on a timeline basis. However, the same continues to be on the higher side vis-à-vis peers. While gearing is expected to remain within manageable levels in case of timely completion of IPO, any significant delay in proposed IPO may result in high gearing levels over the short to medium term.

**Corporate Governance**

Overall corporate governance framework has improved over time with conversion of the company into a public unlisted company and improvement in board composition (increase in board size and induction of independent directors). Management is in the process of further improving internal control framework through strengthening of internal audit function, finalization of SoPs and installation of a SAP or Oracle based ERP system. JCR-VIS will track progress against planned initiatives, going forward.

## ISSUE/ISSUER RATING SCALE & DEFINITION

### 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

**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](http://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](http://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

#### 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.

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](http://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.

## JCR-VIS Credit Rating Company Limited

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

REGULATORY DISCLOSURES					
Appendix III					
<b>Name of Rated Entity</b>	Agha Steel Industries Limited				
<b>Sector</b>	Steel Industry				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>RATING TYPE: ENTITY</b>				
	December 5, 2017	A	A-1	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
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