RATING REPORT

Agha Steel Industries Limited

REPORT DATE:
January 18, 2021

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A/A-2**	**A-/A-2**
Sukuk	**A+**	**A**
Rating Date (Entity)	*January 18, 2021*	*October 18, 2019*
Rating Outlook	Stable	Stable

COMPANY INFORMATION	
Incorporated in 2013	**External auditors:** Haroon Zakaria and Company Chartered Accountants
	Chairman of the Board: Mr. Iqbal Hussain Agha
Key Shareholders:	**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.vis.com.pk/kc-meth.aspx***

Agha Steel Industries Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Agha Steel Industries (ASIL) was established in FY12 as a partnership concern (AOP). ASIL operated as an AOP till May 31st, 2017. On June 1st 2017, Agha Steel Industries Limited (ASIL) took over the Net Assets of ASI (AOP) leaving no business behind with AOP. 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 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 Textiles and Denim International.

RATING RATIONALE

Agha Steel Industries Limited (ASIL) stands amongst the top-tier players in the long steel sector with installed capacity of billets and reinforcement bars (rebars) at 450,000MTs and 250,000MTs, respectively. Recently, in Nov'2020, ASIL was publicly listed on the Pakistan Stock Exchange (PSX). The amount of Rs. 3.6b raised in the IPO is planned to be utilized for capacity expansion. After the expansion, the capacity of rebars will increase to 650,000MTs. The enhanced capacity of rebars is expected to come online in Aug'21. In addition, the capacity expansion will lower the average cost of production translating in a competitive advantage for the company.

Capacity utilization of bars was reported on the lower side at 61% in FY20 when compared to historical average of around 82% from FY16-FY18. Utilization was also lower in FY19 at 50% on account of plant being shut down for BMR. However, lower utilization level in the outgoing year was mainly attributable to the pandemic-induced slowdown, which resulted in operational and demand related challenges for all industry players.

Lower financing cost & positive demand outlook has lower industry's business risk profile

LSM grew by 7.65% in the month of Sep'20 when compared to corresponding period last year while 1QFY21 displayed a growth of 4.81% YoY. Specifically, Billets manufacturing witnessed a notable increase of 38.26% in Sep'20 and 26.03% in 1QFY21 period. The increase in the production is indicative of sharp pick-up in demand in Q1'FY21.

- With the government entering into its last 2 years, infrastructure spending is expected to pick up, which should drive industry demand going forward; particularly GoP's PSDP allocation, CPEC related projects, Naya Pakistan Housing Scheme, Construction Sector Package announced by PM, while lower interest rates should serve as an added stimulant. Nevertheless, downside risk, in the short-tern, remains elevated on account of the ongoing 2nd wave of Covid-19.

Ratings take into account business risk of the long steel sector while also factoring in technological and pricing competitive advantage of ASIL

- Business risk of the long steel sector is viewed as high, given its sensitivity to exchange rate & interest rate changes and price volatility of raw material. For ASIL, the core raw material is scrap metal, which consists of around 60-65% of the manufacturing cost. ASIL imports its raw material from China.
- The sector is supported by strong sovereign protection through import tariffs like ~ 39% (RD of 15%; ADD of 24%) and ~ 49.5% (RD of 30%, ADD of 19.15%) duty on Chinese imported billets and rebars, respectively.
- ASIL's competitive advantage stems from the company being the only manufacturer using Electric Arc Furnace (EAF) for manufacturing of billets
    - EAF has lower energy costs; offers savings of 20%-25% of the total electricity cost.
    - EAF technology, being modern, is up to the standard and fully compliant with the current environmental regulations vis-à-vis induction melting, which has been banned in certain jurisdictions.
    - EAF provides added ease of changing material as per customer requirements.
    - EAF is less labor intensive vis-a-vis an Induction Furnace and saves labor cost up to PKR 200/MT.
    - EAF is 10% higher efficient, in terms of yield recovery, than an Induction Furnace.
    - EAF is capable of producing high carbon and low carbon Billets, a feature that is not available through induction melting.

Capacity enhancement phase I was concluded in 2018 while phase II of capacity expansion is on the anvil

- In order to cater to rising demand, ASIL completed the BMR and Expansion Phase I of its existing facilities in 2018.

- The phase II of the expansion is expected to cost Rs. 7b, of which 51% (Rs. 3.6b) is planned to be funded through the IPO proceeds, while the remaining will be funded by a combination of long & short term debt. The aforementioned phase II of the expansion will increase the rolling capacity by 450,000MT.
- The phase II of expansion features acquisition of the Mi.Da. Rolling Mill, which is characterized by a single strand Continuous Casting-Rolling process featuring ultra-high speed Power Mold Caster, in-line billet inductive heating as well as bar quenching and tempering system, and a Direct Rolling Bundling system, all arranged in an extremely compact layout. All this, along with the continuous uninterrupted production cycle from raw material to finished product, and with the extreme compactness of the technological area, will allow ASIL to be one of the most cost-efficient plants of Pakistan.
- This is the most competitive way to produce Rebars in terms of Capital Expenditure and Operating Expenditure. Mi.Da. Rolling Mill is considered as a winning strategy for the best integration of the most advanced technologies to allow to be the most competitive in steel production.
- Mi.Da. Rolling Mill is a super compact unit as compared to the traditional mini mills. It requires almost 49% less space and requires 23-hours/day uninterrupted production.

Topline grew, despite pandemic-induced slowdown, backed by both volumetric growth and increase in pricing. Nevertheless, increased finance costs weighed on the bottom line

- Including the sales contraction of 2% in FY19, the topline of the company posted a 5-Yr CAGR of 9%, while the same grew by 28% in FY20. Increased volumetric growth and higher selling price of Rebar both contributed in the increased topline.
- Gross margin rebounded to 24% in FY20 from 20% in FY19 (FY18:25%). In Q1'FY21, some contraction in gross margins has been noted to 22%.

Margins Trend (%)	FY16	FY17	FY18	FY19	FY20	Q1'FY21
Gross Margin	23%	27%	25%	19%	24%	22%
Operating Margin	21%	24%	20%	17%	23%	18%
Net Margin	15%	15%	14%	7%	9%	10%

- Company has performed efficiently on the operating front as administrative expenses were lower by 3%, while selling and distribution expenses were up by 24%, mainly attributable to the strong growth in sales.
- Given significant increase in interest rate during FY20, the cost of debt for the company increased from 8.0% to 9.6% (based on a two-point average). In Q1'FY21, given the drop in benchmark rates in Q4'FY20, the cost of debt was lower at 5.4%.
- Net margin of ASIL inched up to 9% during FY20 (FY19: 8%, FY18: 14%).

Cashflow coverage indicators remain under pressure, albeit are expected to improve in the short term

	FY18	FY19	FY20	Q1'FY21
Operating Cycle (Days)	**309**	**423**	**361**	**241**
- Debtor Days	100	116	103	69
- Inventory Days	233	330	306	192
- Payable Days	24	23	47	20
FFO	1,702	1,085	1,529	663
FFO - Debt	34%	14%	7%	8%
FFO – Long Term Debt	103%	38%	19%	20%
DSCR	2.1	1.3	1.7	2.1*
***Annualized**				

- The company operates with an operating capital of close to 1 year, which is on the higher side. Accordingly the company has to rely on running finance to meet working capital needs. As of Sep'20 the company's capital structure, in terms of debt-equity stood at 70:30, with 62% of the debt being short-term.
- In FY20, given the increase in debt, the cash flow coverage of debt has been impacted, as

illustrated in the table above.

- Nevertheless, the notably higher sales off take in Q1'FY21 and the resultant improvement in cash flows, the DSCR (annualized) has risen above 2x.
- Going forward, DSCR is expected to remain elevated (>1.7x) during FY21, in view of the quantum of debt maturity during the year. Loan repayment cost is expected to spike in FY22, wherein DSCR is likely to fall, albeit should still remain above 1x.
- Overall cash flow coverage of debt is expected to remain around 10%.
- Short term debt on the books is covered by inventory and trade debts to the tune of 1x, as of Sep'20.

Gearing has come down on a timeline, and further dip is expected once recently raised capital is incorporated

- ASIL had significantly increased its long term debt in FY18 and FY19 via issuing Sukuk and taking financing in order to perform capex activities. In FY20, the company's debt increased by 22%, albeit capital structure, in terms of debt to equity, remained stationary at 70:30.
- Gearing and leverage of the company have trended down since our last review. Incorporating the most recent equity infusion, the company's gearing is expected to fall below 1.7x, assuming debt remains at similar level as reported on Sep'20.
- Given improved profitability projections, and assuming full retention, gearing and leverage are projected to further trend down during the rating horizon.

	Jun'18	Jun'19	Jun'20	Sep'20
Equity	**5,480**	**6,903**	**8,160**	**8,669**
Gearing	2.27x	2.32x	2.39x	2.34x
Leverage	2.56x	2.96x	2.67x	2.54x

Agha Steel Industries Appendix I

FINANCIAL SUMMARY (Rs. in m)					
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**Q1'FY21**
Fixed Assets	4,698	8,552	10,666	13,826	14,767
Stock-in-Trade	2,633	5,171	7,520	8,627	8,364
Trade Debts	1,957	2,977	3,413	3,840	3,869
Cash & Bank Balances	0	34	243	68	71
Total Assets	11,517	19,492	24,509	29,958	30,728
Trade and Other Payables	301	531	424	1,339	870
Long Term Debt	1,881	4,470	5,770	7,512	7,607
Short Term Debt	3,871	7,944	10,111	11,950	12,655
Total Debt	5,752	12,414	15,881	19,462	20,262
LTD/TD	32.7%	36.0%	36.3%	38.6%	37.5%
STD/TD	67.3%	64.0%	63.7%	61.4%	62.5%
Paid-up Capital	3,614	3,614	3,614	4,561	4,561
Total Equity*	4,699	5,480	6,966	8,160	8,669
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**Q1'FY20**	**Q1'FY21**
Net Sales	10,688	10,461	13,427	3,855	5,890
Gross Profit	2,693	2,142	3,269	795	1,108
Finance Cost	(419)	(921)	(1,703)	(476)	(270)
Profit Before Tax	1,938	1,763	607	1,390	659
Profit After Tax	1,456	811	1,236	318	509
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**FY20**	**Q1'FY21**
Gross Margin (%)	27.3%	25.2%	19.4%	24.3%	22.0%
Net Margin	15.2%	13.6%	7.3%	9.2%	10.1%
Net Working Capital	315	1,036	2,253	1,211	913
Trade debts/Sales	20%	28%	33%	29%	16%**
FFO	1,944	1,702	1,085	1,529	663
FFO to Total Debt (%)	34%	14%	7%	8%	13%**
FFO to Long Term Debt (%)	103%	38%	19%	20%	35%**
Current Ratio (x)	1.1	1.1	1.2	1.1	1.1
Debt Servicing Coverage Ratio (x)	2.3	2.1	1.3	1.7	2.1**
Gearing (x)	1.22	2.27	2.32	2.39	2.34
Leverage (x)	2.07	2.56	2.96	2.67	2.54
Stock+Trade Debts/STB	1.19	1.03	1.09	1.04	0.97
ROAA (%)	14%	9%	4%	5%	7%**
ROAE (%)	52%	39%	29%	13%	24%**

** Equity includes loan from directors*
***Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITION — Appendix II

VIS Credit Rating Company Limited

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	Agha Steel Industries Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity and Sukuk Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
18-Jan-2021	A	A-2	Stable	Upgrade
18-Oct-2019	A-	A-2	Stable	Downgrade
01-Mar-2019	A	A-1	Stable	Reaffirmed
05-Dec-2017	A	A-1	Stable	Initial

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: SUKUK			
18-Jan-2021	A+	Stable	Upgrade
18-Oct-2019	A	Stable	Downgrade
01-Mar-2019	A+	Stable	Reaffirmed
24-Aug-18	A+	Stable	Final
25-Apr-18	A+	Stable	Preliminary

Instrument Structure

Value of the Sukuk is Rs. 5b (inclusive of a green shoe option of Rs. 1b). The tenor of the instrument will be 6 years inclusive of a grace period of 2 years. Security structure of the Sukuk entails formation of a collection account through which 70% of the inflows of the company will flow through designated collection accounts maintained with collection banks. Moreover, a debt payment account (DPA) will be maintained (which will be filled through collection account) with the agent bank which will be build up with 1/3rd of the upcoming installment each month by the 10th day such that the entire upcoming installment is deposited in the DPA by the 10th day of the 3rd month.

The security structure also includes first pari-passu charge over present and future fixed assets (with a margin of 25%) and lien over and set-off rights in respect of all transaction accounts. The Sukuk shall be listed on the OTC market.

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.

Disclaimer

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Kamran Ahmed	CFO	December 3, 2020