RATING REPORT

Agha Steel Industries Limited

REPORT DATE:
April 25, 2018

RATING ANALYSTS:
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RATING DETAILS	
	Initial Rating
Rating Category	**Long-term**
Sukuk	A+
Rating Outlook	Stable
Rating Date	*25th April 2018*

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

Agha Steel Industries (ASI) was established in FY12 as a partnership concern (AOP). ASI 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) 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% (FY17: 91%, FY16: 85%) during 1HFY18.

Expansion Plans

In order to cater to rising demand backed by increased development and construction activities in the country, ASIL is in the process of expanding its capacity. The expansion will take place in two phases:

- The first phase involves BMR of existing facility which will increase melting capacity of billets and rolling capacity of rebars to 450,000MT and 250,000MT, respectively. The targeted date of commissioning is June'2018.
- The second phase of expansion involves installation of Danieli's direct rolling mill (MI.DA® Plant) which shall increase rolling capacity to 650,000MT. Phase II is expected to come online by December'2019 and provide the company with a technological edge over its competitors.

Besides increased sales volume, the expansion will also benefit the company with various efficiencies. These include lower power, re-heating and labor cost. The improved furnace technology for the existing plant is being imported from Danieli based in Italy. Cost savings generated by this BMR are as follows:

- Lower power consumption shall aid savings of Rs. 2,500/MT.
- Decrease in labor requirement shall provide savings of Rs. 250/MT.
- Re-heating cost saving shall provide savings of Rs. 1,500/MT.
- High conversion yield billets and rebars shall also result in increased savings.

The total cost for the aforementioned expansions is forecasted at around Rs. 7b. Cost of expansion of phase-1 is Rs. 3b, of which, around 85% has been incurred to date. The remaining Rs. 4b will be incurred through a mix of debt and equity.

Sector Dynamics

Overall sectoral risk is considered high given the fragmented nature of the industry, expected increase in competition post capacity expansion by established existing and new players (Aggregate capacity of established players increasing by around 3(x)), significant reliance of the sector on duty protection and cyclical nature of the industry. However, outlook for the sector has witnessed improvement on the back of robust demand due to investment in development of infrastructure & power generation and increase in duty protection against imports from China.

Higher demand and imposition of Regulatory Duty (RD) & 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 and in the ongoing year. Local players enjoy 39% (RD of 15%; ADD of 24%) and 49.5% (RD of 30%, ADD of 19.15%) duty protection on imported billets and rebars, respectively. Any significant change in duty structure is expected to materially impact business risk profile of the sector. Post expansion, top-tier integrated players (undergoing capacity expansion) will benefit from significantly lower cost of production vis-à-vis smaller non-integrated players and therefore will be relatively better positioned.

Sales and Market Penetration

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.

Financial Profile

Profitability of the company has witnessed double digit growth during FY17 and 1HFY18 on the back of increased volumetric off-take and healthy gross margins which compare favorably to peers. JCR-VIS expects gross margins of industry players to decline from existing levels from the latter half of FY19 given the sizeable capacities coming online and resultant increase in competition. ASIL anticipates post expansion efficiency benefits enjoyed by integrated top-tier players to help sustain gross margins.

With increase in profitability, ASIL's funds from operations (FFO) amounted to Rs. 1b (FY17: Rs. 1.9b, FY16: Rs. 1.3b) during 1HFY18. FFO in relation to outstanding obligations has witnessed improvement with debt servicing coverage being strong at 2.8(x) (FY17: 2.3(x); FY16: 2.0(x)) during 1HFY18. Key risk to timely debt servicing include significant delay in planned expansion, change in duty structure, increase in raw material & power cost beyond levels that can be passed on to customers and slowdown in demand due to delays in execution of major infrastructure projects.

The company's working capital cycle requires utilization of short-term borrowings. While trade debts have increased overtime, ageing profile of trade debts is considered satisfactory. With an increase in debt levels to fund higher raw material inventory, trade debts and Phase 2 expansion, leverage indicators are projected to increase from current levels. Planned Initial Public Offering in the latter half of the ongoing year will facilitate in reducing leverage indicators. However, continuity of high leverage indicators beyond benchmark for the assigned ratings will trigger a rating review.

Structure of the Sukuk

The company intends to raise Rs. 5b (inclusive of a green shoe option of Rs. 1b) through a Sukuk issuance in the last quarter of the ongoing year. The Sukuk will have a total tenor of six years (inclusive grace period of two years since the date of the first drawdown). Majority of the proceeds of the Sukuk will be utilized to settle existing long term debt while the remaining shall be used to fund planned expansion. 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. Given the debt servicing mechanism in place and even after significantly sensitizing for lower than projected revenues and margins, cushion in debt servicing is projected to remain adequate. 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.

Corporate Governance

Overall corporate governance framework has improved over time with conversion of the company into a public unlisted company, improvement in board composition (increase in board size and induction of independent directors) and oversight. 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 based ERP system. JCR-VIS will track progress against planned initiatives, going forward.

Agha Steel Industries **Appendix I**

FINANCIAL SUMMARY (Rs. in m)

BALANCE SHEET	FY15	FY16	FY17	1HFY18*
Fixed Assets	3,864	4,061	4,698	5,914
Stock-in-Trade	3,967	3,163	2,633	3,234
Trade Debts	1,212	1,714	1,957	2,684
Cash & Bank Balances	7	1	0	52
Total Assets	9,616	10,106	11,517	14,287
Trade and Other Payables	797	833	301	561
Long Term Debt	2,541	2,106	1,881	2,483
Short Term Debt	4,311	3,956	3,871	4,932
Total Debt	6,852	6,063	5,752	7,415
LTD/TD	37.1%	34.7%	32.7%	33.5%
STD/TD	62.9%	65.3%	67.3%	66.5%
Total Equity	1,836	3,113	3,733	4,560
INCOME STATEMENT				
Net Sales	8,477	8,768	9,943	10,904
Gross Profit	1,575	2,037	2,713	2,895
Finance Cost	(678)	(477)	(418)	(453)
Profit After Tax	670	1,292	1,515	1,654
RATIO ANALYSIS				
Gross Margin (%)	18.6%	23.2%	27.3%	26.5%
Net Margin	7.9%	14.7%	15.2%	15.2%
Net Working Capital	93	567	315	475
Trade debts/Sales	14%	20%	20%	25%
FFO	807	1,349	1,944	2,030
FFO to Total Debt (%)	12%	22%	34%	27%
FFO to Long Term Debt (%)	32%	64%	103%	82%
Current Ratio (x)	1.0	1.1	1.1	1.1
Debt Servicing Coverage Ratio (x)	1.5	2.0	2.3	2.8
Gearing (x)	3.73	1.95	1.54	1.63
ROAA (%)	7%	13%	14%	13%
ROAE (%)	44%	52%	44%	40%

** Annualized*

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

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	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				
5-Dec-2017	A	A-1	Stable	Initial

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: SUKUK			
25-April-18	A+	Stable	Preliminary

Instrument Structure

Value of the proposed 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

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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