RATING REPORT

Agha Steel Industries Limited

REPORT DATE:
March 01, 2019

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A/A-1**	**A/A-1**
Sukuk	**A+**	**A+**
Rating Date (Entity)	*March 01, 2019*	*December 5, 2017*
Rating Date (Sukuk)	*March 01, 2019*	*August 24, 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

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 450,000MT and 250,000MT, respectively. ASIL's electric arc furnace for melting is a competitive advantage vis-à-vis peers. The company completed Phase I of its expansion which involved BMR of existing facility and enhanced billets and rebar capacity by 200,000MT and 100,000MT respectively.

Capacity utilization level of bars was reported on the higher side at 92% (FY17: 91%) during FY18. However, post the first phase of expansion and lower demand, utilization levels have witnessed a sharp decline at end-September'2018. The management projects gradual increment in utilization levels over the months on the back of improved demand outlook.

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 mid-2020 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 total cost for Phase II has been estimated at around Rs. 3.5b, three-fifth of which will be funded through company's internal cash flows with the remaining being on supplier's credit for a period of 2 years. In order to control supply chain right till the end customer and strengthening its retail footprint, ASIL opened its first branch in Hyderabad while other branches are in the pipeline.

Sector dynamics have weakened due to slowdown in demand and sizeable capacities coming online

Overall sectoral risk is considered high given the fragmented and cyclical nature of industry, expected increase in competition post capacity expansion by established existing and new players and significant reliance on duty protection. However, local players enjoy ~ 39% (RD of 15%; ADD of 24%) and ~ 49.5% (RD of 30%, ADD of 19.15%) duty protection on Chinese imported billets and rebars, respectively, and thus resulting in improved pricing power of industry players. While dumping margins have reduced given significant rupee depreciation, risk of dumping from China is considered moderate given supply constraints due to ban on use of induction furnace.

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. VIS expects pressure on financial performance of non-integrated and inefficient players (ungraded sector) to be more pronounced vis-à-vis top-tier players. Going forward, demand growth is expected to remain subdued in the short-term in line with slower economic growth in the backdrop of increasing interest rates and sizeable current account deficit. However, demand outlook over the medium to long-term is expected to remain healthy given focus of the government on construction of dams and housing units.

Profitability to witness pressure due to slowdown in demand and significant jump in finance cost. Cost savings due to BMR and low priced scrap to provide some respite to profitability

Sales revenue of the company witnessed growth of 8% during FY18 on account of volumetric growth and increase in average selling prices. However, in 1QFY19, the company recorded depressed sales revenue amounting to Rs. 1.6b on account of plant being shut down for expansion. 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. Going forward, achievement of projected sales revenue is contingent upon increase in capacity utilization levels and gradual improvement in off-take.

While declining on a timeline basis, gross margins (GMs) of the company remained healthy during FY18 and was reported at 25% (FY17: 27%). GMs declined further to 23% during 1QFY19 due to lower capacity utilization. Despite significant rupee depreciation, management expects to maintain GMs in the ongoing year due to significant power cost savings post completion of BMR and sizeable low priced raw material inventory. Net profitability of the company witnessed attrition during the outgoing year due to higher operating expenses, exchange losses and increase in finance charges. VIS expects profitability to remain under pressure owing to sizeable finance charges in the backdrop of sharp rise in interest rate and slow-down in demand.

Cash flow coverage of outstanding debt has declined on a timeline basis to fund expansion. Trade debts in relation to sales have witnessed a noticeable jump. Ageing profile of trade debts is considered adequate

Cash flow coverage of outstanding total debt has witnessed a noticeable decline on a timeline basis to 14% (FY17: 34%) on account of decline in cash flows and sizeable debt undertaken to fund expansion. While declining on a timeline basis, cash flow coverage of outstanding long-term debt remains adequate at 38%. Trade debts in relation to sales have witnessed a noticeable jump from 20% at end-FY17 to 28% at end-FY18. The company's working capital cycle requires utilization of short-term borrowings. Ageing profile of trade debts is considered satisfactory within around 90% of trade debts being overdue within three months. At end-June'2018, stock in trade in relation to trade debts represented 103% (FY17: 119%) of outstanding short term borrowings. Given the grace period on outstanding long-term Sukuk there are limited repayments of long-term debt due till January'2021. Key risk to timely debt servicing include further slowdown in demand, delay in planned expansion, change in duty structure and increase in raw material cost beyond levels that can be passed on to customers.

Elevated leverage indicators due to sizeable borrowings undertaken

During October'2018, the company issued a Sukuk to replace its existing long term debt. Despite issuance of the Sukuk, debt levels were reported on the higher side led by an increase in short-term debt to fund raw material inventory and trade debts. Given pressure on profitability and elevated debt position, leverage indicators are projected to remain on the higher side. Going forward, improvement in leverage and gearing indicators is considered important from a ratings perspective.

Adequate 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 has further improved internal control framework through strengthening of internal audit function, finalization of SoPs and installation of a SAP based ERP system.

Agha Steel Industries **Appendix I**

FINANCIAL SUMMARY (Rs. in m)					
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**	**1QFY19***
Fixed Assets	3,864	4,061	4,698	8,552	9,562
Stock-in-Trade	3,967	3,163	2,633	5,171	5,126
Trade Debts	1,212	1,714	1,957	2,977	2,381
Cash & Bank Balances	7	1	0	34	50
Total Assets	9,616	10,106	11,517	19,492	19,791
Trade and Other Payables	797	833	301	531	174
Long Term Debt	2,541	2,106	1,881	4,470	3,942
Short Term Debt	4,311	3,956	3,871	7,944	8,310
Total Debt	6,852	6,063	5,752	12,414	12,252
LTD/TD	37.1%	34.7%	32.7%	36.0%	32.2%
STD/TD	62.9%	65.3%	67.3%	64.0%	67.8%
Total Equity**	1,836	3,113	4,699	5,480	6,381
INCOME STATEMENT					
Net Sales	8,477	8,768	9,943	10,688	1,645
Gross Profit	1,575	2,037	2,713	2,693	375
Finance Cost	(678)	(477)	(418)	(419)	(125)
Profit After Tax	670	1,292	1,515	1,456	225
RATIO ANALYSIS					
Gross Margin (%)	18.6%	23.2%	27.3%	25.2%	22.8%
Net Margin	7.9%	14.7%	15.2%	13.6%	13.7%
Net Working Capital	93	567	315	1,036	298
Trade debts/Sales	14%	20%	20%	28%	36%
FFO	807	1,349	1,944	1,702	186
FFO to Total Debt (%)	12%	22%	34%	14%	6%
FFO to Long Term Debt (%)	32%	64%	103%	38%	19%
Current Ratio (x)	1.0	1.1	1.1	1.1	1.0
Debt Servicing Coverage Ratio (x)	1.5	2.0	2.3	2.1	1.1
Gearing (x)	3.73	1.95	1.22	2.27	1.92
ROAA (%)	7%	13%	14%	9%	5%
ROAE (%)	44%	52%	39%	29%	15%

** Ratios Annualized*

*** Equity includes loan from directors in FY17 and 1QFY19*

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				
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			
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.
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