RATING REPORT

Agha Steel Industries Limited

REPORT DATE:
March 01, 2022

RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**A/A-2**	**A/A-2**
Sukuk	**A+**	**A+**
Rating Date (Entity)	March 01, 2022	January 18, 2021
Rating Outlook	Stable	Stable

RATING ANALYSTS:
Asfia Aziz
asfia.aziz@vis.com.pk

Muhammad Taha
m.taha@vis.com.pk

COMPANY INFORMATION	
Incorporated in 2013	**External auditors:** Haroon Zakaria and Company Chartered Accountants
Public Listed Company	**Chairman of the Board:** Ms. Shazia Iqbal Agha
Key Shareholders:	**Chief Executive Officer:** Mr. Hussain Iqbal Agha
Mr. Iqbal Hussain Agha – 35.04%	
Mr. Raza Iqbal Agha - 15.83%	
Mr. Hussain Iqbal Agha – 15.83%	
Ms. Shazia Iqbal Agha – 12.55%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (August 2021)
CorporateMethodology202108.pdf (vis.com.pk)

Agha Steel Industries Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

Agha Steel Industries (ASIL) was incorporated in Pakistan on November 19, 2013 as a private limited company. On April 7, 2015 ASIL was converted into a public limited company. On November 02, 2020, the company had its IPO, which generated proceeds of Rs. 3.84 billion.

The Company is principally engaged in manufacturing and sale of steel bars, wire rods and billets, and its registered office and production plants are Port Qasim Authority, Karachi.

Profile of the CEO: *Since taking up this role, Mr. Hussain Iqbal Agha has remained actively involved in plant operations, business management , and strategic planning to ensure sustainable growth of the company. At present, he is leading the ongoing expansion plan that is expected to significantly increase capacity and improve overall efficiency.*

The board comprises 7 members and is chaired by Ms. Shazia Iqbal Agha. Two Non-executive directors were added in the outgoing year including Mr. Muhammad Asif and Mr. Amer Hazim Haji.

Agha Steel Industries Limited (ASIL) stands amongst the top-tier players in the long steel sector, and is involved in the manufacturing and sale of billets and reinforcement bars (rebars). As part of the BMR and expansion project that started in 2018, the company was able to increase the capacity of re-bars and billets to 250,000 MT (per annum) and 450,000 MT (per annum), respectively. In Nov'20 ASIL raised Rs. 3.8b through an IPO. Funds generated from the same were utilized for the Phase II of the expansion plan, which involves further enhancing the production capacity of bars by installing a state of the art Mi.Da. Rolling Mill and an air separation unit.

At end-1HFY22, most civil works related to the project has been completed. The project is expected to commence operations by Nov-Dec'22. Post commencement, the installed capacity for bars will mount to 650,000 MT per annum. Capacity utilization for bars was reported on the lower side at 61% in FY21, as the economy continued to recover post Covid-19. Utilization levels are projected to improve going forward due to a positive demand outlook.

	2020	2021
	Metric Tons	
Billets		
Capacity	450,000	450,000
Actual Production	182,852	179,981
Bars		
Capacity	250,000	250,000
Actual Production	153,604	151,449

Business risk profile is supported by positive demand outlook along with technological competitive advantage of ASIL, offered by the use of state of the art technology.

Business risk for the sector is considered to be on the higher side due to its sensitivity to exchange rate and volatile nature of raw material prices. 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. Shredded scrap prices remained at record high levels over the last 18 months and surged from $263 per MT in June 2020 to around $570 per MT in February 2022. The withdrawal of 13.5% export rebate by the Chinese government further added to supply side pressure, as China dominates the worldwide production of steel. Going forward, supply side issues may persist due to the Chinese government's policy to shut down plants because of environmental concerns. On the flip side, the Government of Pakistan continues to offer protection to the sector from foreign suppliers by imposing 46% (5% CD, 15% RD, 2% ACD, and 24% ADD) and 43% (11% CD, 30% RD, and 2% ACD) duty on the import of billets and bars from China.

Despite challenges arising from the global demand supply dynamics, demand for steel products has witnessed an increase over the last year. Government of Pakistan's package for the construction sector and the initiative of Naya Pakistan Housing Scheme have offered a real stimulus in this regard. Going forward, the construction of dams along with these factors is likely to ensure that an upward trend in demand is a sustainable one.

ASIL's technological competitive advantage stems from the use of Electric Arc Furnace (EAF) for manufacturing of billets. The following are some key advantages of being the only manufacturer using EAF facility:

- 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 can also utilize a certain proportion of DRI scrap which is around $100/MT cheaper than shredded scrap.
- 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.

In addition to ERF, the installation of air separation unit is also expected to help reduce the dependency on external sources for the supply of gases required as part of the production process. Furthermore, The Mi. Da. Rolling project (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) is near completion as well. Once it becomes operational, the whole production cycle from raw material to finished product (bars) will be efficiently streamlined, allowing ASIL to be one of the most cost efficient plants of Pakistan.

Topline growth accountable to both volumetric increase in sales and higher average selling prices.

Revenue for FY21 was reported at Rs. 19.9b, an increase of around 48% year-on-year (FY20: Rs. 13.4b, FY19: Rs. 10.5b). Around 84% of sales comprises re-bar sales which depicted a growth of 30% in FY21 contributed by an 18% increase in volumes and 11%

increase in prices. The proportion of revenue generated from billets has gone up to around 15% over the last 18 months, as compared to around 5% during FY20, primarily due to a substantial increase in sales volumes of billets. The upward trend in topline growth has continued in 1HFY22, with the company registering sales of Rs. 12.6b in the period. Ongoing expansion plans expected to be completed in 1HFY23 coupled with positive demand outlook, management projects stable revenue growth going forward. Timely completion of the expansion plan to meet projected indicators is considered important from a ratings perspective.

Gross Margins declined to around 23% (FY20: 24.3%, FY19: 19.4%) in FY21 and 1HFY22 being a function of higher raw material prices. However, the same compare favorably to other peers in the industry due to the ability to pass on the input price hike to consumers along with efficiencies translating from the EAF. Net profitability was supported by lower finance costs in FY21 due to lower utilization of short term financing. Net margins were reported at 10.3% (FY20: 9.2%, FY19: 7.3%). In 1HFY22, the same reduced slightly to 9.2% due to one-off exchange loss on unwinding of supplier's credit.

Improving liquidity profile on a timeline basis. Continuance of the same is considered important from a ratings perspective.

Cash flow coverages for the company showed improvement at end-1HFY22, with FFO to Total debt and FFO to Long-term Debt being reported at 15% (FY21: 14%, FY20: 8%) and 40% (FY21: 30%, FY20: 20%), respectively. A noticeable increase in the quantum of short-term debt was observed at end-Dec'21 to finance additional working capital needs. Despite that, stock-in-trade and trade receivables provide sufficient cover against short-term debt (1HFY22: 1.18x, FY21: 1.38x, FY20: 1.04x). With principal payment of Sukuk deferred last year amidst COVID-19, a sizeable amount of repayment is due in the ongoing year, consequently weakening the debt servicing ability of the company to 1.23x (FY21: 2.0x, FY20: 1.7x) at end-Dec'21. Loan repayment cost is expected to spike going forward, wherein DSCR is likely to fall, albeit should still remain above 1x. Overall cash flow coverage of debt is expected to remain around 10%. Further improvement in liquidity profile is considered important.

Capitalization indicators have improved on a timeline basis supported by profit retention and IPO proceeds.

Equity base of the company surged to Rs. 13.8b (FY20: Rs. 8.2b, FY19: Rs. 6.2b) at end-FY21 on account of incorporation of IPO proceeds and sizeable profit retention. This led to a marked improvement in capitalization indicators, with leverage and gearing ratios reported lower at 1.56x (FY20: 2.67x, FY19: 2.96x) and 1.40x (FY20: 2.39x, FY19: 2.59x), respectively at end-FY21. During 1HFY22, the incremental short-term borrowings were partially offset the upward trend in profit, with the leverage indicators increasing but remaining within manageable levels. Going forward, the company is projected to sustain the growth momentum in equity base and gradually repay its long-term loans. Given improved profitability projections, and assuming full retention, gearing and leverage are projected to further trend down during the rating horizon.

FINANCIAL SUMMARY (Rs. in m)					
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**1HFY22**
Fixed Assets	8,552	10,374	13,826	17,066	18,546
Stock-in-Trade	5,171	7,757	8,627	9,505	12,737
Trade Debts	2,977	3,366	3,840	4,047	4,565
Cash & Bank Balances	34	243	68	833	476
Total Assets	19,492	24,507	29,958	35,411	41,008
Trade and Other Payables	531	530	1,339	1,011	905
Long Term Debt	4,470	5,837	7,512	9,469	9,101
Short Term Debt	7,944	10,171	11,950	9,829	14,617
Total Debt	12,414	16,008	19,462	19,298	23,718
LTD/TD	36.0%	36.5%	38.6%	49.1%	38.4%
STD/TD	64.0%	63.5%	61.4%	50.9%	61.6%
Paid Up Capital	3,614	3,614	4,561	5,761	6,049
Total Equity	5,480	6,182	8,160	13,811	14,988
INCOME STATEMENT					
Net Sales	10,688	10,482	13,427	19,858	12,568
Gross Profit	2,693	2,031	3,397	4,503	2,844
Finance Cost	(419)	(1,135)	(1,703)	(1,409)	(745)
Profit Before Tax	1,763	607	1,517	2,553	1,420
Profit After Tax	1,456	769	1,363	2,036	1,178
RATIO ANALYSIS					
Gross Margin (%)	25.2%	19.4%	25.3%	22.7%	22.6%
Net Margin	13.6%	7.3%	10.2%	10.3%	9.4%
Net Working Capital	1,036	2,245	1,211	3,893	2,920
Trade debts/Sales	28%	32%	29%	20%	9%
FFO	1,702	1,085	1,529	2,795	1,837
FFO to Total Debt (%)	14%	7%	8%	14%	15%
FFO to Long Term Debt (%)	38%	19%	20%	30%	40%
Current Ratio (x)	1.1	1.2	1.1	1.3	1.2
Debt Servicing Coverage Ratio (x)		1.3	1.7	2.0	1.23
Gearing (x)	2.27	2.59	2.39	1.40	1.58
Leverage (x)	2.56	2.96	2.67	1.56	1.74
Stock+Trade Debts/STB	1.03	1.09	1.04	1.38	1.18
ROAA (%)		3%	5%	6%	6%
ROAE (%)		13%	19%	19%	16%

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				
Mar-01- 2022	A	A-2	Stable	Reaffirmed
18-Jan-2021	A	A-2	Stable	Upgrade
18-Oct-2019	A-	A-2	Stable	Downgrade
01-Mar-2019	A	A-1	Stable	Reaffirmed

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: SUKUK			
Mar-01-2022	A+	Stable	Reaffirmed
18-Jan-2021	A+	Stable	Upgrade
18-Oct-2019	A	Stable	Downgrade
01-Mar-2019	A+	Stable	Reaffirmed

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 is 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	February 08, 2022
Mr. Muneeb Khan	Company Secretary	February 08, 2022