

## RATING REPORT

### Agha Steel Industries Limited (ASIL)

**REPORT DATE:**

December 21, 2023

**RATING ANALYSTS:**

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**RATING DETAILS**

Rating Category	Latest Rating	Previous Rating
Entity	A/A-2	A/A-2
Rating Date	December 21, 2023	December 13, 2022
Rating Outlook	Stable	Negative
Rating Action	Maintained	Maintained
Sukuk 3	A+	A+
Rating Date	December 21, 2023	August 25, 2023
Rating Outlook	Stable	Stable
Rating Action	Reaffirmed	Final

**COMPANY INFORMATION**

Incorporated in 1948	External auditors: M/s. Reanda Haroon Zakaria & Company Chartered Accountants
Public Listed Company	Chairman of the Board: Mrs. Shazia Iqbal Agha
	Chief Executive Officer: Mr. Hussain Iqbal Agha
Key Stakeholders (with stake 5% or more):	
Local General Public – 27.73%	
Mr. Hussain Iqbal Agha – 25.72%	
Mr. Raza Iqbal Agha – 24.34%	
Mr. Saad Iqbal – 8.67%	
Insurance Companies – 5.01%	

**APPLICABLE METHODOLOGY(IES)**

VIS Entity Rating Criteria Methodology – Industrial Corporates

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

VIS Rating the Issue

<https://docs.vis.com.pk/docs/Rating-the-Issue-Aug-2023.pdf>

**APPLICABLE RATING SCALE(S)**

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

## Agha Steel Industries Limited (ASIL)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p><b>Agha Steel Industries Limited (ASIL)</b> was founded in Pakistan on November 19, 2013, as a private limited company, later listed as a public entity on April 7, 2015. Its Initial Public Offering (IPO) raised a notable of Rs.3.84 billion, highlighting ASIL's growth and market confidence.</p> <p>ASIL primarily focuses on the production and sale of steel bars, wire rods, and billets. The Company's registered office and manufacturing facilities are strategically located at Port Qasim Authority in Karachi.</p> <p><b>CEO Profile: Mr. Hussain Iqbal Agha</b> Since assuming leadership, Mr. Hussain Iqbal Agha has been playing a pivotal role in transforming steel industry with hands-on ASIL's plant operations, business management, and strategic foresight, and driving the Company towards sustainable growth. Currently, he spearheads an ambitious expansion plan aimed at substantially enhancing production capacity and elevating operational efficiency.</p> <p>The board comprises 7 members and is chaired by Mrs. Shazia Iqbal Agha, with two executive directors, three independent directors, and company's CEO.</p>	<p><b>Corporate Profile</b></p> <p>Agha Steel Industries Limited ('ASIL' or 'the Company') was established in Pakistan on November 19, 2013, as a private limited company. On April 07, 2015, ASIL transitioned to a public limited company. The Company was listed on the Pakistan Stock Exchange in November 2020 generating proceeds amounting to PKR 3,840 million from its initial public offering (IPO).</p> <p>The central operation of ASIL's business is focused on the production and sale of steel bars, wire rods, and billets. Agha Steel Industries Limited (ASIL) holds a distinct technological advantage in the steel industry through its utilization of the Electric Arc Furnace (EAF) for billet manufacturing. This advanced technology not only provides significant cost savings but also offers flexibility in the production process. The Company's registered office and manufacturing facilities are located at Port Qasim Authority, Karachi.</p> <p><b>Launch of Agha Green as the first wholly owned subsidiary of Agha Steel Industries</b></p> <p>Agha Green has been launched as a green initiative by ASIL as a step to benefit the Company, the environment, and Pakistan's steel industry. With the launch of Agha Green, ASIL will be able to reduce its CO2 emissions by millions of tons/years, reduce ASIL's energy consumption by up to 31%, and reduce scrap wastage amount by 5%. However, successful implementation and operation of MIDA rerolling mill technology as a key component of this green initiative will be a key constraint in future.</p> <p><b>Sukuk 3 Term Structure:</b></p> <p>ASIL issued a Sukuk of size PKR 3.4 bln on August 17, 2023, as a debt swap for the prepayment of the Company's previous outstanding Sukuk issue. The instrument has a tenor of 4 years which includes a grace period of 1.5-years. Specific terms include:</p> <ul style="list-style-type: none"> <li>• The principal shall be paid in equal quarterly installments commencing from the 21st month after issuance.</li> <li>• The issue is secured by: <ol style="list-style-type: none"> <li>1. First pari-passu hypothecation charge over all present and future fixed assets of the Company with a margin of 25%.</li> <li>2. First pari-passu equitable mortgage charge over the Company's rights in immoveable property with a 25% margin.</li> <li>3. Any shortfall in the same will necessitate cash equity injections by the Company's sponsors, as per the Sponsor Support Agreement.</li> </ol> </li> <li>• The Company is required to deposit one third of the upcoming coupon payment each month in a Debt Payment Account (DPA).</li> </ul>

### Key Rating Drivers

**Business risk profile: High due to exposure to cyclicalities and competition, nevertheless ASIL's technological advantage provides comfort to ratings.**

VIS considers the business risk within long steel industry to be 'High'. In FY23, the country's economic landscape was constrained with various factors, including supply disruptions linked to the repercussions from the floods in the 1H FY23, surging inflation, the depreciation of the local currency, and dwindling foreign exchange reserves. Seeking to stabilize the economy, the State Bank of Pakistan raised interest rates, while the government introduced measures such as import restrictions, energy price hikes, and increase in corporate taxes. Resultantly, these fiscal and monetary actions inadvertently disrupted supply chains, leading to a significant contraction of GDP to 0.29% in FY23, a sharp decline from the 5.7% growth reported in FY22. The market size was notably reduced due to the contraction in construction activities in the country.

Moreover, the long steel sector in Pakistan is highly fragmented and intensely competitive, hosting more than 300 melting and re-rolling mills. However, only a handful of companies are considered top-tier players, with ASIL being one of them. The Pakistan Association of Large Steel Producers (PALSP) comprises approximately 52 members, collectively controlling about 70% of primary steel production in the country. Nevertheless, ASIL, along with other large players, faced challenges in maintaining high-capacity utilization. In FY23, ASIL, along with Mughal Iron & Steel and Amreli Steels, managed to utilize only 35.7% of their combined billet production capacity, a significant decline from the 56.3% achieved in FY22. Simultaneously, rebar production capacity utilization declined from 55.5% in FY22 to 33.5% in FY23, underscoring subdued demand in the sector.

While the high steel prices somewhat mitigated the impact of reduced capacity utilization on revenue, the sector witnessed a significant decline in profitability. The industry's gross margins were squeezed by high input costs, and elevated finance costs further constrained the bottom line. The spike in finance costs was attributed to the heightened interbank rates during the year.

However, due to these factors persisting in the country many of the smaller players have exited the industry, providing larger players with greater pricing power. This has allowed these players, especially ASIL, to retain their margins despite volumetric decline in sales.

**Operational Profile: ASIL's technological advantage provides operational efficiencies that offer support to ratings.**

ASIL has over the years invested heavily in its production process, which provides it with technological competitive advantage in the industry. With the installation of the Electric Arc Furnace (EAF) the Company is expected to receive the following benefits:

- Lower energy costs; offers savings of 20-25% of the total electricity costs.
- 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.

- Can utilize a certain proportion of DRI scrap which is around \$100/MT cheaper than shredded scrap.
- Provides added ease of changing material as per customer requirements.
- Less labor-intensive vis-a-vis an Induction Furnace and saves labor cost up to PKR 200/MT.
- Has 10% higher efficiency, in terms of yield recovery, than an Induction Furnace.
- Is capable of producing high carbon and low carbon Billets, a feature not available through induction melting.

In addition to EAF, the installation of air separation unit helps the Company 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. As of November 2023, the MiDa plant has successfully achieved cold commissioning, while load commissioning and full operational commissioning are expected in 2HFY24.

**Profitability Profile: Top line deterioration from volumetric demand contraction; strong margins continue to provide support to ratings.**

In FY23, ASIL reported a reduction in its revenue, primarily stemming from a ~20% decline in sales volume. This decrease was due to the contraction of construction activities within the country. However, ASIL was able to improve its gross margins, to 23.4% (FY22: 21.4%) in FY23. This increase was mostly driven by the Company's operational efficiencies from its technological advantage. Moreover, slightly higher pricing power, with many smaller players exiting the industry, provided further support to profitability.

Management expects its margins to further improve as MiDa becomes operational in the coming months. Through this integration management expects an approximate 5% increase in the Company's gross margins in FY24. Furthermore, we expect a modest improvement in demand, as demonstrated by a slight uptick in recent cement sales, reflecting a marginal rise in construction activity in the country.

Improvement in the top line and maintenance of profitability adequate with assigned ratings will remain a key consideration for future ratings.

**Capitalization Profile: Adequate, however, slight pressure expected from the upcoming issuance of green bond.**

ASIL's capitalization profile continues to remain adequate, with gearing and leverage ratios of 1.3x (FY22: 1.5x) and 1.5x (FY22: 1.6), respectively in FY23. Capitalization factors exhibited slight improvement on account of regular debt repayment and lower short-term debt utilization.

With its upcoming issuance of a PKR 3.5 bln green bond, the Company's capitalization profile is expected to face slight pressure in FY24. However, management anticipates this strain to ease as regular repayments bring gearing and leverage back to acceptable levels over time.

Going forward, maintenance of capitalization profile at commensurate level with assigned ratings would be a key rating consideration going forward.

**Liquidity and Coverage Profile: Adequate, but improvement will remain important for ratings.**

In FY23, due to severe constraints of Funds from Operations (FFO), the Company experienced deterioration in its liquidity and coverage profiles. However, as a result of effective debt management by the Company, the liquidity and coverage profiles recovered to adequate levels by 1QFY24. Going forward, the Company is expected to maintain liquidity and coverage levels consistent with its assigned ratings. This is based on steady improvement in operational cash flows over time, supported by operationalization of the MiDa project and the anticipated uptick in demand. Moreover, sensitized projection continued to provide comfort to ratings with sufficient cushion in coverage and liquidity.

Credit enhancement for the Sukuk is supported by the Sponsor Support Agreement, which necessitates cash equity injections by the Company's sponsor in case of any shortfalls.

## Agha Steel Industries Limited

## Appendix I

<b>FINANCIAL SUMMARY</b> <i>(PKR Millions)</i>				
<b>BALANCE SHEET</b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>3MFY24A</b>
Property, plant and equipment	17,066.4	19,149.1	21,277.4	21,727.4
Stock-in-trade	9,505.3	12,299.7	10,439.9	10,502.5
Trade debts	4,047.0	5,271.9	4,948.8	4,292.3
Cash & bank balances	833.2	215.1	87.3	237.7
Total Assets	35,410.7	41,477.3	41,980.0	42,065.7
Trade and Other Payables	1,011.1	1,128.7	829.4	580.1
Long-term Debt (incl. current portion and lease liability)	9,469.3	8,907.7	8,479.8	8,287.3
Short-term Debt	9,828.8	14,045.9	13,728.9	13,999.2
Total Debt	19,298.1	22,953.6	22,208.6	22,286.5
Total Liabilities	21,599.9	25,811.7	25,409.5	25,370.0
Paid up Capital	5,760.8	6,048.8	6,048.8	6,048.8
Equity (excl. Revaluation Surplus)	13,810.8	15,665.6	16,570.4	16,695.7
Equity (incl. Revaluation Surplus)	13,810.8	15,665.6	16,570.4	16,695.7
<b>INCOME STATEMENT</b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>3MFY24A</b>
Net Sales	19,858.2	25,647.9	20,582.2	5,253.1
Gross Profit	4,502.5	5,490.3	4,820.0	1,209.2
Operating Profit	3,723.0	4,121.0	4,026.0	1,006.2
Finance Costs	1,409.0	2,135.8	3,208.7	952.2
Profit Before Tax	2,553.4	2,288.4	1,168.3	160.8
Profit After Tax	2,036.0	1,854.8	904.9	125.3
<b>RATIO ANALYSIS</b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>3MFY24A</b>
Gross Margin (%)	22.7%	21.4%	23.4%	23.0%
Net Margin (%)	10.3%	7.2%	4.4%	2.4%
Funds from Operation (FFO)	2,795.4	3,341.9	1,551.0	321.2
FFO to Total Debt* (%)	14.5%	14.6%	7.0%	5.8%
FFO to Long Term Debt* (%)	29.5%	37.5%	18.3%	15.5%
Gearing (x)	1.4	1.5	1.3	1.3
Leverage (x)	1.6	1.6	1.5	1.5
Debt Servicing Coverage Ratio* (x)	1.0	1.0	0.6	1.1
Current Ratio	1.3	1.1	1.0	1.2
(Stock in trade + trade debts) / STD (x)	1.4	1.3	1.1	1.1
Return on Average Assets* (%)	6.2%	4.8%	2.2%	1.2%
Return on Average Equity* (%)	18.5%	12.6%	5.6%	3.0%

\*Annualized, if required

REGULATORY DISCLOSURES					Appendix II
<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>	Sukuk 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><u>RATING TYPE: ENTITY</u></b>				
	21-Dec-2023	A	A-2	Stable	Maintained
	13-Dec-2022	A	A-2	Negative	Maintained
	01-Mar-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
	05-Dec-2017	A	A-1	Stable	Initial
	<b><u>RATING TYPE: SUKUK 3</u></b>				
	21-Dec-2023	A+		Stable	Reaffirmed
	25-Aug-2023	A+		Stable	Final
	07-Jul-2023	A+		Stable	Preliminary
	<b><u>RATING TYPE: SHORT-TERM SUKUK</u></b>				
	21-Dec-2023		A-1		Preliminary
<b>Instrument Structure(s)</b>					
<p>ASIL has issued a Sukuk of size PKR 3.4 bln on August 17, 2023, as a debt swap for the prepayment of the Company's previous outstanding Sukuk issue. The instrument has a tenor of 4 years which includes a grace period of 1.5-years. The principal shall be paid in equal quarterly installments commencing from the 21st month after issuance. The issue is secured a first pari-passu hypothecation charge over all present and future fixed assets of the Company with a margin of 25%. In addition, another first pari-passu equitable mortgage charge over the Company's rights in immoveable property with a 25% margin. Moreover, any shortfall in the same will necessitate cash equity injections by the Company's sponsors, as per the Sponsor Support Agreement. The Company is required to deposit one third of the upcoming coupon payment each month in a Debt Payment Account (DPA).</p> <p>The Company has proposed a PKR 2.0 bln short-term sukuk with a tenor of up to 6 months from issuance. The profit rate will be 6M KIBOR plus a spread yet to be finalized. Principal redemption occurs as a bullet payment upon maturity, with profit payable at that time. The sukuk is secured by a ranking charge on the Company's present and future fixed assets with a 25% margin. Additionally, there's a pari passu charge over the Company's present and future current assets with a 25% margin. Up to 40% of the amount will be invested in Treasury Bills or any other government security as further security. The Company is required to maintain a Debt Service Reserve Account (DSRA) that accumulates up to 60% of the issue amount's principal and profit payment on the 25th day of the fifth month from the issue date. This accumulation will be 1/5 of the principal and profit installment from the 25th day of each month after the issue date.</p>					
<b>Statement by the Rating Team</b>					
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.			
<b>Probability of Default</b>	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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<b>Due Diligence Meetings Conducted</b>	<b>S.No.</b>	<b>Name</b>	<b>Designation</b>	<b>Date</b>
	1.	Mr. Ahmed Ateeq	Deputy CEO	
	2.	Mr. Muhammad Muneeb Khan	Company Secretary	November 8, 2023
	3.	Mr. Sher Ali	Manager Corporate Ratings	