The Pakistan Credit Rating Agency Limited

RATINGS (OCTOBER 2009)

AMRELI STEELS LIMITED (ASL)

	Initial
Sukuk ***(PKR 1,000 mln)*** ***Secured, Privately Placed***	**A**

FINANCIAL DATA

PKR (mln)

	Jun-09*	Jun-08	Jun-07
Total Assets	4,264	4,246	2,683
Equity	1,270	1,185	882
Net Turnover	4,129	3,625	3,581
Net Income	(524)	101	84
EBITDA	(89)	417	267
ROA %	n.a	2.9	3.4
ROE %	n.a	9.8	8.8
Net Debt / EBITDA (x)	n.a.	5.9	4.8
EBITDA Net Interest Cover (x)	n.a	1.9	1.9
Net Debt/Equity %	196.2	208.5	146.4

* Based on unaudited accounts

ANALYSTS

Samiya Mukhtar
+92 42 35869504
samiya@pacra.com

Rana Muhammad Nadeem
+92 42 35869504
nadeem@pacra.com

PROPOSED SUKUK:

- The company intends to issue a Sukuk of PKR 1,000mln. The proceeds of the instrument would mainly be utilized to re-profile its existing short term borrowings. The issue would be for a term of seven years including a grace period of two years. The profit is payable at 3 month KIBOR plus 250bps quarterly in arrears.
- At least 24% of the Issue amount would be redeemed during a period of three years starting after the grace period and the balance amount in sixth and seventh year in quarterly installments
- Sukuk holders would have first pari passu charge on all present and future fixed assets of ASL (equal to total principal amount) whereas 25% margin amount shall be covered through a charge on current assets.
- ASL would maintain a reserve of two installments (principal plus interest). Reserve, equivalent to one installment, would build, in equal amounts, over first eight quarters of the first draw down. Additional reserve of another installment would be added to the said reserve amount during next four quarters. Thereafter, the reserve account would be maintained at a level equivalent to at least two upcoming installments.

RATING RATIONALE AND KEY RATING DRIVERS

- The rating reflects Amreli Steel's established franchise and its ownership and governance structure which is expected to strengthen by addition of new equity partner – JS Private Equity. Existing sponsors – Akberali Family – have demonstrated their commitment to support the company in case the need arises. The company's cash flows in the medium term may remain under stress owing to the ongoing backward integration of re-rolling plant. However, the rating draws comfort from grace period in principal repayment and expected improvement in profitability and cash flows in post integration scenarios.
- The rating depends upon company's ability to timely roll out its strategic plan to set-up its own melting plant. Any material delay in execution of this project would impact the performance prospects of the company. Meanwhile, further strengthening of its financial profile while managing its debt burden at adequate level would remain critical.

ASSESSMENT

- ASL is principally engaged in manufacturing and sale of reinforcement bars – rebars, which are utilized for construction purposes. Steel billets are used as the raw material for rebars. In Pakistan the major supplier of billets is Pakistan Steel Mills and remaining is procured through imports. Generally, the demand of steel is aligned with the business cycle of the economy and, in particular, the level of construction activity in the country. However, the slowdown in local economy, which started in second half of FY08, and otherwise increasing prices of commodities worldwide at that time – including metals – added volatility to the steel business.
- During the past few years ASL witnessed a reasonable revenue growth and sustained gross margins, emanating from increased demand, capacity expansion and steady rise in steel prices. However, with unprecedented swing in steel prices during FY09, the overall operating environment for the company became challenging. Amreli steels incurred significant inventory losses due to accumulation of high cost inventory during the preceding year in initial part of FY09 leading to negative gross margins. The company's capacity utilization also remained significantly low (FY09: 46%; FY08:69%) owing to weak demand. As a result, gross margins declined to -0.5% (FY08:13.7%). Though the company managed to control its operational costs, there was a significant increase in interest expense on account of a) working capital requirements, b) capex, and c) increase in interest rates. Consequently, the company incurred a huge loss of PKR523mln which eroded all the accumulated profits of ASL. Nevertheless, sponsors' timely equity injection not only helped the company sustain its business but also funded its ongoing capital expenditure.
- The management, cognizant of inherent volatility in raw material supply, decided to vertically integrate its operations to manage the inefficiencies related to supply of raw material – both in terms of quantity as well as prices. With an estimated cost of US$37mln, the company is setting up a steel melting shop – a billet manufacturing plant[1] with a capacity of 190,000 tons. This initiative is expected to help the company a) attain a smooth supply of raw materials, b) optimal level of production, c) supplement its revenue through sale of surplus billets, and d) improve its margins, going forward. However, till the execution of this project, which is expected to be operational in Jan 2011, the company remains dependent on imports and local suppliers of billets. At the same time, interest cost would remain an important concern as significant portion (around 50%) of this project is expected to be financed through borrowing.
- ASL, as part of its plan to improve governance structure, systems, and process, has taken various initiatives interalia, engaging a recognized external audit firm, improving of MIS reporting – though gradually, and formulation of various management committees to strengthen its control mechanism.
- Despite the fact that cash flows of the company remained under stress in the past, the company managed to maintain its debt servicing coverages at reasonable level mainly because of low leveraging. Considering the on going capex would require further capital injection, the company intends to raise funding through a combination of debt and equity. Going forward, given expected improvement in profitability and the sponsors' commitment to maintain an optimal mix of debt and equity in the intervening period, coverages are expected to improve.

PROFILE:

- ASL, incorporated in 1984, is fully owned by Akberali Family, which has been engaged in steel and allied businesses since early forties. The company uses modern technology for producing high quality steel bars according to British and American standards, with an installed capacity of 150,000 tons per annum. Currently, Akberali Family is at an advanced stage to engage JS Private Equity as new partners in Amreli Steels. JS Private Equity Fund, subsequent to proposed equity injection of PKR 665mln, would have 40% ownership stake in Amreli Steels.
- Currently ASL's board is family dominated. However, with the participation of JS Private equity at ASL's board (planned three seats out of seven), the governance structure is expected to improve
- Mr. Abbas Akberali, the CEO of the company, is a metallurgical engineer and holds an MBA degree from Columbia University, USA. He has around four decades of experience in local and the Middle-East markets. He is assisted by a team of relatively young but well-qualified professionals.

[1] Civil works, land development and design engineering of this plant are almost complete and a capex of around US$5.3mln has already been incurred.