The Pakistan Credit Rating Agency Limited

Rating Report

Amreli Steels Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
18-Dec-2018	A	A1	Stable	Maintain	-
14-Jun-2018	A	A1	Stable	Maintain	-
29-Dec-2017	A	A1	Stable	Maintain	-
27-Mar-2017	A	A1	Stable	Maintain	-
28-Oct-2016	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Amreli Steels' healthy business profile on account of the company's market positioning in the industry. The company is currently working on a expansion project which would result in capacity enhancement to 600,000tpa from 400,000tpa of billets by Feb-19. Amreli has already achieved 605,000tpa of re-rolling capacity in Apr-18 and average 400,000tpa billets capacity in Aug-17. During the first quarter of FY19, the board of directors has approved the second phase of expansion of rolling capacity from 605,000tpa to 1,105,000tpa subject to the approval of technical feasibility and successful financial close. Capacity additions by competitors is likely to heat up competition, herein, effective and timely management of capacity expansion remains important for Amreli. The company has stepped up efforts to ensure supportive supply chain to utilize enhanced capacities in a timely manner. Meanwhile, regulatory protection to the finished product (rebar) is an added advantage for the sector. The company's changes to organizational structure are likely to bring enhanced efficiency. The business profile of the company remained healthy on the back of enhanced capacity, improved business volumes. However, margins declined, an industry wide phenomenon, primarily driven by increased international scrap prices. The leveraging might increase in medium term in pursuit of expansion. The ratings draw comfort from strong business acumen of Amreli Steels' sponsors - Akberali Family.

The ratings are dependent on the management's ability to sustain its business profile while benefiting from positive demand fundamentals. Utilization of enhanced capacity and upholding business margins is vital. Moreover, prudent management of financial affairs remains important.

Disclosure

Name of Rated Entity	Amreli Steels Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Steel(Jan-18)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Amreli Steels Limited is a public limited company listed on Pakistan Stock Exchange since December 2015 and is traded under the section of Engineering.

Background Amreli Steels' rebar production facility is situated at S.I.T.E Karachi and the melt shop is situated in industrial zone at Dhabeji, Port Qasim. Expansion equating to a total of PKR 1bln is ongoing on steel melt shop at dhabeji to increase capacity from 400,000tpa to 600,000tpa. During FY18, commencement of commercial operations of the new rolling mill at Dhabeji increased the rebar production capacity of Amreli to 605,000 tons p.a (FY17:180,000 tons p.a).

Operations Amreli Steels produces two key products: i) steel billets, ii) rebars including a) Grade 60 Deformed Steel bars and b) Xtreme bars (G-500W). All Xtreme bars are cut in standard sizes of 12-16 meters. Amreli Steels has the largest billet manufacturing plant in Pakistan with a capacity of producing 400,000 tons of billets. The SMS Plant produces billets in sizes ranging from 100x100mmsq to 200x200mmsq. The Company's entire power need is being fulfilled by K-Electric.

Ownership

Ownership Structure The company is majority (75%) owned by Akberali family, followed by Financial Institutions (18%), and general public (~7%).

Stability The Company's ownership structure witnessed minor changes post IPO. However, majority stake will rest with Akberali family.

Business Acumen The sponsors _ Akberali family carries experience of more than six decades of successfully managing steel and allied business. The willingness towards the business is evident from the steadfast approach used by the management. Hence, sponsor's business acumen is considered strong.

Financial Strength The sponsors have demonstrated their commitment towards the company by injecting funds on as and when required basis. Given that Amreli is the flagship entity of sponsors, willingness to support the company in case the need arises is considered high; also supplemented by access to capital markets.

Governance

Board Structure The overall control of board vests in seven-member board of directors, wherein four are from sponsoring family including the Chairman and CEO, while three are independent members.

Members' Profile Amreli arranges orientation courses for its directors on as and when required basis. The incoming directors are also provided with appropriate briefing and orientation material to equip them with first-hand knowledge on the company.

Board Effectiveness There are two board committees in place, these include: (i) Audit, and (ii) Human Resource & Remuneration. Audit Committee comprises two independent members and one non-executive director from sponsoring family. In FY18, four board meetings were held. Attendance of board members in these meetings is considered good.

Financial Transparency M/s EY Ford Rhodes Sidat Hyder, Chartered Accountants, classified in category 'A' by SBP and having a QCR rating, are the external auditors of the company. They have expressed an unqualified opinion for the Financial statements of year ended 30th, June 2018.

Management

Organizational Structure Amreli has a multi-tier organizational structure. Including two senior positions i) COO-Strategy and ii) COO-Operations and Chief Financial Officer and six functions i) Marketing, ii) Govt. and Public Relations, iii) Information Technology, iv) Corporate Affairs & Liaison, v) New Businesses, and vi) CSR and communication reports to Chief Operating Officer-Strategy. Other eight functions; i) Sales, ii) Finance, iii) Supply Chain, iv) Admin & IR, v) Plant Operations, vi) Human Resource, vii) Security and Vigilance, ix) Environmental Health & Safety are reporting to COO-Operations and Chief Financial Officer. Internal audit function reports to Audit Committee.

Management Team Mr. Shayan Akberali, the elder son of Mr. Abbas Akberali, is lately appointed CEO. He is an engineer by profession and has been associated with the company since last two decades. Mr. Hadi Akberali, the younger son, has been promoted to the position of COO – Strategy. He was previously working as Executive Director – Business Development. Mr. Fazal Ahmed, the previous CFO has been promoted as 'COO – Operations and CFO'.

Effectiveness Amreli has five management committees in place. These committees review key performance areas of the company, inter-alia, daily production analysis, yield analysis, mechanical or production breakdown and downtime analysis.

MIS The company has implemented SAP as an ERP solution with following operational modules, i) Production planning, ii) Material Management, iii) Sales and Distribution, iv) Finance, v) Controlling, and vi) Human Capital Management including success factor module. Reports generated on daily basis include sales and collection, production, major customers receivables report, and quality inspection report.

Control Environment The Company has internal control systems and procedures in place to ensure the quality of goods produced on a continuing basis.

Business Risk

Industry Dynamics Domestic steel industry is undergoing expansions announced in previous government's regime. With the commencement of capacity expansions, industry player's performance in current scenario of slowdown in infrastructure projects remains vital. Regulatory protections in form of increased anti-dumping duties is a positive. However, improved business performance and margins is essential for industry players in era of growing interest rate, exchange rate and expected inflationary environment in foreseeable future.

Relative Position Amreli is one of the bigger players in domestic steel industry. The company is undergoing capacity expansion, in phases, which will enhance company's foot print and market positioning.

Revenues During FY18, topline witnessed growth of 17% YoY (FY18: PKR 15.5mln, FY17: PKR 13.2mln). Sales mix is majority tilted towards local market while exports are only a small portion. The company's operating expenses (administrative and marketing expenses rose by 26% and 12% respectively). However, the company posted operating profit of PKR 1.9bln (FY17: PKR 1.8bln). Furthermore, Finance cost increased to PKR 476mln (FY17: PKR 252mln) driven by increase in long-term finance and short-term finance. Despite of aforementioned factors, the company managed to report profit after tax of PKR 1.5bln (FY17: PKR 1.0bln), up 48% YoY. During the 1QFY19, the company secured a topline of PKR 5.9mln (1QFY18: PKR 2.7mln); significant increase driven by recently achieved capacity expansions.

Margins Amreli's margins have slightly declined over the past year. (Gross: 1QFY19: 15%, FY18: ~18%, FY17: ~19%, Operating: 1QFY19: ~11%, FY18: 13%, FY17: 14%). Also, EBITDA margin witnessed a downstick (1QFY19: ~7%, FY18: 9%, FY17: 11%). The upward trend in international scrap prices (~30%) during FY18 also contributed towards slimming business margins.

Sustainability Going forward, as of Nov'18 the board has also approved the third phase of expansion plan for setting up an additional rolling mill at Dhabeji to further expand its rebar manufacturing facility from 605,000mt/p.a (FY17: 180,000mt/p.a) to 1,105,000mt/p.a. Meanwhile, the management is continuing its marketing efforts to expand its geographical footprint.

Financial Risk

Working Capital During FY18, Amreli's working capital requirements represented by net cash cycle – a function of inventory, receivables and payables - increased to 164days (end-Jun17: 153days) driven by increase in inventory days (FY18: 128days; FY17: 107days). The company manages its working capital requirements through mix of internally generated cash and short term borrowings. On account of stretched working capital cycle, the company's short term borrowings increased significantly (FY18: PKR 8,399mln, FY17: PKR 4,165mln). Current ratio remained at comfortable level of 1.1x.

Coverages During FY18, EBITDA increased by 14% YOY, standing at PKR 2.3bln (end-Jun17: PKR 2.0bln). FCFO increased to PKR 2,004mln (FY17: PKR 2,091mln). However, surge in finance cost and higher debt intake weakened the coverages (interest: end-Jun18: 4.2x, end-Jun17: 7.1x; debt service: end-Jun18: 1.6x, end-Jun17: 3.2x). Going forward, utilization of enhanced capacity will assist in comfortable repayment of long term debt.

Capitalization Over the last few years, the company has been operating at low leveraged capital structure. However, recently company acquired long-term financing for capacity expansion. The company's leveraging stands at ~47% as at end Jun18 (end-Jun17: 32%). ~74% of the debt outstanding pertains to short-term (end-Jun17: ~80%). The company's equity base improved over the last few years to PKR ~13bln (end-Jun17: PKR 11bln). Continuing on, owing to debt driven expansion, the leveraging is bound to increase but is expected to remain range bound.

PKR mln

Amreli Steels Limited

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
	9M	9M	Annual	Annual
Non-Current Assets	**15,929**	**15,692**	**12,403**	**8,600**
Investments	**15**	**15**	**15**	**315**
Current Assets	**12,559**	**10,935**	**5,791**	**7,850**
Inventory	8,577	7,459	3,404	4,410
Trade Receivables	2,382	1,788	1,455	2,071
Others	1,601	1,689	931	1,370
Total Assets	**28,504**	**26,643**	**18,209**	**16,765**
Debt	**10,955**	**11,380**	**5,189**	**4,181**
Short-term	7,998	8,399	4,165	3,171
Long-term (Inlc. Current Maturity of long-term debt)	2,957	2,981	1,024	1,009
Other shortterm liabilities	3,079	1,221	652	683
Other Longterm Liabilities	1,181	1,162	1,222	1,212
Shareholder's Equity	**13,289**	**12,880**	**11,146**	**10,690**
Total Liabilities & Equity	**28,504**	**26,643**	**18,209**	**16,765**

INCOME STATEMENT	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
Turnover	**5,922**	**15,501**	**13,284**	**12,400**
Gross Profit	908	2,758	2,468	2,792
Operating profit	643	1,971	1,806	2,234
Financial Charges	(209)	(476)	(252)	(330)
Net Income	**409**	**1,585**	**1,074**	**1,279**

Cashflow Statement	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
Free Cashflow from Operations (FCFO)	681	2,004	1,796	2,193
Net Cash changes in Working Capital	(1,484)	(4,223)	1,854	(3,195)
Net Cash from Operating Activities	(936)	(2,614)	3,406	(1,354)
Net Cash from InvestingActivities	(400)	(2,924)	(4,133)	(1,293)
Net Cash from Financing Activities	1,272	5,599	416	2,949

Ratio Analysis	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
Performance				
Turnover Growth (same period last year)	118.8%	16.7%	7.1%	-14.0%
Gross Margin	15.3%	17.8%	18.6%	22.5%
Net Margin	6.9%	10.2%	8.1%	10.3%
ROE	12.7%	14.6%	10.0%	13.8%
Coverages				
Interest Coverage (x) (FCFO/Gross Interest)	3.3	4.2	7.1	6.6
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.7	1.6	3.2	2.7
Debt Payback (Years) (Total LT Debt Including UnCovered Total STBs)/(FCFO- Gross Interest)	1.6	2.0	0.7	0.5
Liquidity				
Net WC Days (Inventory Days + Receivable Days - Payable Days)	153	164	153	145
Short-term Total Leverage (Net Current Assets - STB) / Current Assets	11.8%	12.0%	16.8%	50.9%
Capital Structure (Total Debt/Total Debt+Equity)	45.2%	46.9%	31.8%	28.1%

Rating Scale

Credit Rating Scale & Definitions

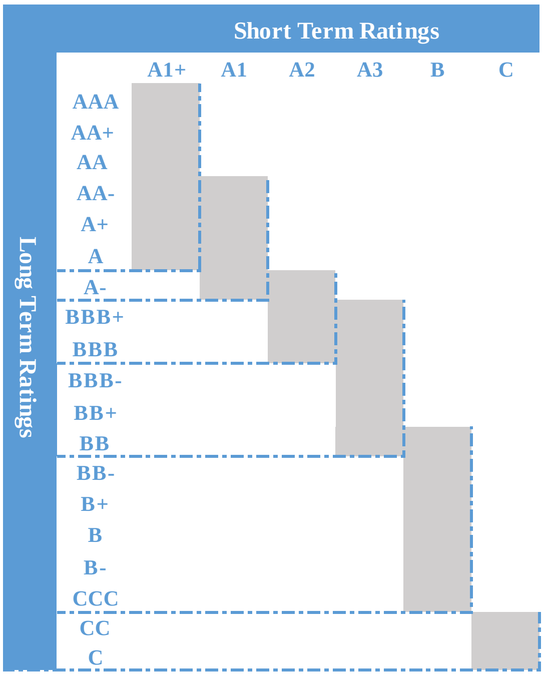
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information