Directors' Report

The Directors of International Steels Ltd are pleased to submit the 6th Annual Report and the audited accounts for the year ended June 30, 2013.

Global Steel Scenario

In the period 2012-13 the international steel market remained uncertain and unpredictable. Despite a slight increase in demand for steel, growth in global steel demand is unlikely to improve significantly in 2013-14 owing to sluggish demand combined with excess steelmaking capacity globally and ongoing volatility in raw materials costs. China, the largest market in the steel sector, has also experienced lower demand, a fragmented industry and weak profit margins resulting in potential slow- down of growth. The Chinese Government, in the short term, now seems to be discouraging further investments in the steel industry.

It is anticipated that steel markets will remain volatile in 2013-14, but a moderate recovery is expected in 2014–15, with developed markets gradually recovering. Steel demand is likely to improve faster in emerging markets. Pakistan having low barriers to trade, promptly reflects international prices.

Pakistan's Economy

After Elections 2013, the new government is facing many challenges including power crises, law and order issues, low economic growth but they seem to have good governance and economic revival on their agenda and hopefully will take measures accordingly.

The security situation in Karachi that houses ISL's manufacturing facility remains tenuous and unpredictable. The quality of solutions developed, and re-installation of a National Policy Framework will be the key to the nation's economic turnaround and your company is now geared up for the economic turnaround, in terms of technical capability, manufacturing capacity and market acceptance of its products.

Steel consumption in any country is one of the basic indicators to assess economic growth, due to multifarious uses in infrastructure development and industrial growth. In Pakistan the consumption growth is mostly dependent on increase in population, as no major infrastructure or industrial projects are apparent currently unless the new economic policy is defined.

Local manufacturers of Flat Steel Products are currently meeting approx. 50% of Pakistan's demand in Cold Rolled Flat Steel Products and 40% in Galvanised Steel Products. A further un-utilised capacity exists to fulfill some of the remaining demand. Government policies on imports are not being implemented in support of the local industry to enable domestic manufacturers to meet a great share of domestic demand.

Business Review

In line with our mission to be the best flat steel producer in Pakistan and to create a fair value for its shareholders, during 2012-13, we persistently directed all our energies in this direction.

Your Company has a well-thought out, structured manufacturing facilities backed by more than 40 years of steel industry experience, economies of processes and an established marketing network and we are proud to be regarded as amongst the best in the region.

With judicious small-medium investments, the Company regularly improves and debottlenecks its manufacturing process to raise the bar higher each time. During 2012-13, the management 's focus remained on making optimum procurement of raw material in the right quantity and at right prices in a volatile / unpredictable international market, which has been the key to improving cash flows and the reduction of inventory.

Aggressive and timely market postures allowed Company to push sales of Cold Rolled Steel Products as well as Galvanised Steel Products. New marketing channels were established in Pakistan as well as for exports and where required appropriate product variants were also developed and launched.

Strong focus was also maintained in safety & environmental performance, cost reductions, waste reduction, efficiency of operations, quality, and customer service. Particular attention is being paid to customer engagement in the backdrop of product development and trials at customer facilities.

Your Company is facing challenges from lack of effective implementation of Government policies, gaps and loop-holes therein, used by certain importers to benefit themselves at the cost of National Exchequer and value added economic growth. Company's case for a level playing field for locally manufactured Flat Steel Products was regularly placed at the highest levels in Ministry of Commerce, FBR, Pakistan Customs, and the EDB to create and increase awareness at the decision making level in the interest of the local industry and in the larger interests of the Country.

Operations

During 2012-13 production of 221,859 MT was achieved, out of which, approx. 78,435 MT was Cold Rolled Products and about 143,424 MT was Galvanised Steel Products. Our product quality has successfully met the stringent requirements of overseas customers in South Africa and the GCC for local usage there and for re-export to other countries.

Both the Galvanising plant and Cold Rolling Mill have been successfully operated well above name plate capactity. We have added Annealing capacity and strengthened allied processes by adding Tension leveler, electrostatic oiling etc. to meet the market requirements of the Industrial segment including pipe manufacturers, drum and container manufacturers, and the automobile industry.

Our strategy for procurement of raw material in a volatile market was to diversify supply sources and to have a combination of three-month contract purchase and opportunistic, spot purchases, which has helped tackle the volatile steel prices risk during the year under review. Our sources for HR raw material includes Taiwan, China,Russia, South Africa and Japan.

Sales

During 2012-13, our sales reached 217,420 MT, which comprises 63% Galvanized Steel products while the balance 37% being Cold Rolled Steel Products.There is a significant increase of 35% in sales volume over the preceding financial year and our exports have almost doubled as compared to last year.

By the grace of Allah, the market's perception of the company's products is well established for quality, range and delivery. We are viewed as a prudent, ethical supplier and the perception of our Galvanised Steel products is particularly high; where sales volume stability has been achieved. To consolidate this, Customer Service, Marketing, Quality and Factory operations were fully aligned to provide timely and effective response to Customers and to provide meaningful specific solutions as per customers' need.

We have gained a foot-hold in some parts of the industrial segment, and are consolidating a position as a dependable supplier. During 2013-14, we are geared to strongly pursue a greater share of the industrial segment by gaining foot-hold amongst reference industrial customers, and by introducing new applications, which will help business have a higher resilience through sustainable sales volumes and reduced vulnerability to short-term stocking-destocking cycles.

Company continues to consolidate and leverage its nation-wide network of dealers. A diversified, wide network of dealers and Company's field sales teams have helped us reach smaller consumers and institutional, industrial consumers in addition to commercial stockists.

Misuse of SRO 565, misuse of China FTA, mis declared and under-invoiced imports and incorrect fixation of ITP for Secondary quality gave negative pull to Company's plans for growing sales.The company intends to continue to take up these issues alongside other manufacturers at various levels of Government, seeking redressal.

Galvanised Steel

Building on the preceding year, our Galvanized Steel Products are increasingly treated as a benchmark in the Pakistan Commercial market. During 2012-13 the company sold 137,439 MT which is about 27% higher than the preceding year. Approx. 85% of the sales were made to the Commercial segment, while the balance went to the industrial segment or was exported.

The company's products are now being accepted internationally and we have been successful in exporting over 18,000 MT, at competitive prices, an increase of 70% over last year. Our export markets are mainly GCC , South Africa and Afghanistan while smaller opportunistic exports were made to North America / the Caribbean and Sri Lanka.

Cold Rolled Steel

Against a significant headwind, company aggressively marketed Cold Rolled Steel Products and sold 80,274 MT, during 2012-13, an increase of 54% over the preceding year. Approximately 40% of sales were made in the Commercial segment; 56% in the Industrial sector (mainly two wheeler manufacturers) and the balance were exports.

Sale of Electricity to KESC

Company's 19 MW power plant continued to operate satisfactorily. However, production of energy was lower in 2012-13 owing to sustained gas curtailment by SSGC.

The management has invested approx. Rs. 85 million on putting up a 132 kV interconnection, instead of the previous 11 kV connection to overcome frequent tripping. During next financial year, excess energy will be supplied to KESC at 132 kV.

Health, Safety Environment and Quality

Being a responsible corporate citizen, the company carries out annual environmental testing for Air Emissions, Noise, Drinking Water and Industrial Effluents, which shows that Company remains compliant to the NEQS.

Company continues to operate an effective ISO certified mechanism for production operations with adequate focus on implementing HSE standards, Quality standards, waste reduction and energy conservation strategies and to provide continuous training to the employees.

Improved processes and higher awareness levels of employees' has resulted in reduction in the number of total incidents and lost time incidents. Lost Time Injury Frequency Rate for 2012-13 is 2.3; down from 3.3 in the preceding period against global standard for similar industries being 3.5. Company continues to strive for further improvement and towards making its operations better than the benchmark. Our energy consumption per unit produced in the manufacturing process showed a 13% reduction of electricity and natural gas due to conservation measures.
Factory is operated with a fully-functional Effluent and Sewage Treatment Facilities, Acid Regeneration Plant and Acid Fume Scrubbing Units which also provides manufacturing cost reduction benefits.

Human Resource

Company continued its operations with an optimal headcount. The headcount at end 2012-13 was 441. This was judiciously increased by 4% over the preceding year considering the requirements of the expanded production and future goals of business.

Company maintained industrial peace and a positive and enabling work-environment for all employees in the organization by promoting candor and fairness. Company continues its efforts on development of personnel at all levels, proactively building capabilities, and retaining talent for business continuity.

Financials

Your Company achieved Net Turnover of Rs. 17,603 million, registering a healthy growth of 33% over last year, after having ISL brand being recognized as a product leader locally. This was mainly achieved through strict product quality control parameters on a consistent basis.

Despite continued pressure on margins on domestic sales owing to availability of under invoiced and secondary materials being imported into the country, the company earned gross profit of Rs 1,603 million at 9.1% to net sales. Consequently, your company has come into profits after delivering a profit before and after tax of Rs 443 million and 363 million respectively.

Earnings per share at June 30, 2013 was Rs. 0.84 as opposed to a loss per share of Rs 0.24 at June 30, 2012.

Your company has posted profit for the first time. Considering that there is a continuous pressure on margin owing to unfair market parctices, no dividend is declared for the year 2012-13.

Cash Flow Strategy

Your Company is focused towards cash flow management on a regular basis, with a strong control over working capital management. During the current year, your company generates a net cash flow from operations amounting to Rs. 3,430 million with a significant contribution from inventory rationalization.

The company keeps a close watch on gaps between KIBOR and LIBOR based borrowings to rationalize the optimal mix of borrowings and to minimize the financial charges. In this connection, various options including Islamic financings are evaluated and executed.

During the financial year 2012-13, the weighted average cost of borrowings, including exchange losses, was 10.16% per annum as against last year average borrowing rate of 10.7%.

Capital Structure

The long term debt equity ratio of the Company on June 30, 2013 was 45:55 as against 52:48 as on June 30, 2012.

Contribution to National Exchequer and the Economy

The Company made a contribution of Rs. 3,468 million to the National Exchequer during the year. This comprises total of income tax, sales tax, custom duties and other taxes and levies.

Risk Management

The Board meets frequently throughout the year for developing and monitoring the Company's risk management policies.The Company's risk management policies are established to identify and analyse the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities. The Company, through its standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

Internal Controls and their Adequacy

The Audit Committee oversees how management monitors compliance with the Company's risk management policies and procedures, and reviews the adequacy of the risk management framework in relation to the risks faced by the Company.

Gratuity and Provident Funds

The value of investments as per un-audited financial statements of employee retirement funds as of June 30, 2013 are as follows:

Fund Amount

- Provident Fund Rs 42.2 million
- Gratuity Fund Rs 19.2 million

Future Prospects

By the Grace of Allah your Company has stabilized output at well above nameplate capacities and the product is now commanding a premium in the domestic market. We have also been successful in creating a niche in the international market for our product where our product quality is recognized. The major problems we continue to face is pressure on domestic margins due to under invoiced material being imported into the country; import of secondary quality material under SROs; disguised commercial imports under SROs by spurious "manufacturers"; and smuggling/misuse of the Afghan Transit Trade and China FTA. Your management continues to raise this issue at all levels with the concerned authorities and is hopeful with the change in government to have some success.

Barring the impact of uneven playing field, your Company, in its third year of operation, is poised to InshAllah operate with improved value to shareholders.

Acknowledgement

The Board would like to thank all stakeholders; customers, Company employees, suppliers, shareholders, bankers and others for their support and loyalty. Such support enabled Company meet not only normal commercial challenges but also those posed by security issues and tough economic conditions. Such confidence and goodwill of the stakeholders allowed Company to grow, perform and show positive results in a difficult business environment.

We continue to pray to Allah for the continued success of Company and for the benefit of all stakeholders, and the country in general.

Kemal Shoaib
Chairman
Karachi: August 28, 2013