



Directors' Report

The Directors of International Steels Limited are pleased to submit the 7th Annual Report accompanied by the audited accounts for the financial year ended June 30, 2014.

Global Steel Scenario

Although sentiments internationally have broadly improved, developed economies like EU are still facing the challenge of economic recovery and growth.

Prices within the global steel industry remain volatile. Steel prices are, by and large, dictated by iron ore, coking coal and various ferrous metal prices and subject to seasonality. The industry itself is incumbent with outdated technology, fragmentation and over capacity issues. The top 5 steel makers contributed only 17% to the global crude steel output in 2013. This fragmentation has resulted in competition and depressed prices. Over the last 15 years the Chinese steel making industry has increased its output roughly tenfold, resulting in the over-capacity that we see today.

Going forward, prices are expected to stabilize as the Chinese government has taken note of the over-capacity issue and announced elimination of 28.7 million tons of its steelmaking capacity during 2014. In addition, since iron ore prices fell sharply in March 2014, iron ore financing has become increasingly difficult for small to medium sized manufacturers, which will result in reduced supply.

Pakistan's Economy

Steel consumption in any country is one of the basic indicators to assess economic growth as it has multifarious uses in infrastructure development and industrial growth. The Government is today facing numerous challenges including power crises, law and order issues and low economic growth. The Government seems to have good governance and economic revival on their agenda and is focusing on public development schemes including projects like highways and dams which are likely to create demand for steel and allied industries.

The security situation in Karachi that houses ISL's manufacturing facility remains tenuous and unpredictable. Your company is however geared to meet the challenges in terms of technical capability, manufacturing capacity and market acceptance of its products.

Local manufacturers of Flat Steel Products are currently meeting approx. 50% of Pakistan's demand in Cold Rolled Flat Steel Products and 40% in Galvanized Steel Products. A further un-utilised capacity exists to fulfill some of the remaining demand. However, Government policies on imports need to be revisited including the FTA's and proposed MFN status to enable domestic manufacturers to meet a greater share of the domestic demand.

Business Review

During 2013-14, we directed all our energy in the direction of our mission to be the best flat steel producer in Pakistan and to create a fair value for our shareholders.



Your Company is regarded as amongst the best in the region with its well structured manufacturing facilities set-up with more than 40 years of experience in the steel industry, economies of processes and established marketing network.

The Company has improved and de-bottlenecked its manufacturing processes. During 2013-14, management focused on timely procurement of raw material at the right price so as to maintain an optimal level of inventory in order to improve the cash flow of the Company. Our strategy for procurement of raw material in a volatile market was to diversify supply sources and to manage 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, South Africa and Japan.

Our initial investment in equipment to raise the bar for product quality enabled us to enter and establish our brand not only in the local market but also in South Africa, West Indies, Sri Lanka, United Arab Emirates, Jordan, Saudi Arabia and Afghanistan. In addition, judicious attention was given to decreasing cost, reducing wastage, improving operational efficiency, quality control as well as safety & environmental measures. Particular attention was paid to customer service via customized engagement in the backdrop of product development and trials at customer facilities.

Your Company continues to face challenges from lack of effective implementation of Government policies. Misuse of the China FTA, mis-declared and under-invoiced imports and incorrect fixation of ITP for secondary quality imports continue to adversely impact your Company's growth and profitability. The loop-holes therein are used by certain importers to


benefit themselves at the cost of the National Exchequer and value added economic growth. Your Company's case for a level playing field for locally manufactured Flat Steel Products was regularly placed at the highest levels in the Ministry of Commerce, FBR, Pakistan Customs, and the Engineering Development Board. We continue to take up these issues alongside other manufacturers at various levels of Government, seeking redressal as this will not only benefit the local industry but the country's balance of payments.

Operations

During 2013-14 production of the 4 Hi Mill exceeded 281,000 tons, which is well beyond the initially envisaged capacity of 250,000 tons. This production translated into approximately 159,000 MT of Galvanized Steel and 122,000 tons of Cold Rolled products. We expanded the Annealing capacity and strengthened allied processes by adding a Tension Leveler, Electrostatic Oiler and a Roll Shot-blasting machine to meet market requirements. In order to attract high end product manufacturers, your company is in the process of adding a Color Coating Plant which is expected to come into operation in the second quarter of FY 14-15.

Sales

By the grace of Allah, the market's perception of the company's products is well established for quality, range and delivery. We have been recognized as an ethical supplier of a quality galvanized sheets for roofing, ducts and other uses as well as cold rolled sheets for further use in manufacturing by pipe makers, drum & container manufacturers, and the two wheeler & automobile industry. During 2013-14, volume sales increased by 18% over the preceding financial year exceeding



270,000 MT which comprised of 162,000 MT of Galvanised, 95,000 MT of Cold Rolled and 13,000 MT of miscellaneous products.

Your Company continued to consolidate and leverage its nation-wide dealer network, which has been integral in reaching smaller commercial stockists as well as industrial end-consumers.

Sale of Electricity to K- Electric

Company's 19 MW power plant continued to operate satisfactorily and in line with our practice **we continued to supply excess energy to K- Electric at a price that probably remains amongst the cheapest by any I.P.P. in the country.**

However, the production of electricity was lower than last year on account of gas curtailment by SSGC and frequent tripping of the 11 KV circuit. The management has invested Rs. 85 million in installing a 132 KV interconnection to replace the 11 KV and overcome the frequent tripping.

Health, Safety & Environment

Being a responsible corporate citizen, the company carries out annual environmental testing for air emissions, noise, drinking water and industrial effluents to evidence that the Company remains compliant to the NEQS.

Your company continues to operate an effective ISO certified mechanism for production with adequate focus on implementing HSE standards, improved processes and higher awareness levels of employees' has resulted in a safe and healthy workplace environment with minimum accidents.

The factory is operated with fully functional effluent and sewage treatment facilities; acid regeneration plant and acid fume scrubbing units, which also provide manufacturing cost reduction benefits.

Human Resource

The Company continued its operations with an optimal headcount. The headcount at end 2013-14 was 447, which was increased by ONLY 1% over the preceding year despite the additional annealing capacity and additional allied processes.

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

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.

Financials

Net Sales for the FYE June 30, 2014 were Rs. 21.28 billion, registering a healthy growth of 21% over the last financial year. 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 a gross profit of Rs. 2,237 million at 10.5% to net sales as against 9.1% at the last Fiscal Year. This was, however, adversely impacted by lower PKR / USD parity in the second half of the year, thereby, putting pressure on margins to cover inventory purchased at the higher exchange rate. Foreign exchange losses arising owing to fluctuation in exchange rates and in-effective portion on forward cover amounted to Rs. 142 million. In spite of this, your Company has recorded a profit before and after tax of Rs. 874 million and Rs. 690 million respectively as against Rs. 441 million and Rs. 362 million last year.

Earnings per share at June 30, 2014 was Rs. 1.59 as opposed to Rs. 0.83 per share at June 30, 2013.

Dividend

The Board of Directors has recommended a maiden dividend of 10% (Rs.1 per share).



Your Company is focused on continued working capital and cash flow management. During Fiscal 2013-14, your company generated a net cash flow from operations of Rs.1,384 million. Rs. 704 million of this was used to repay long term loans.

Contribution to National Exchequer and the Economy

The Company made a contribution of Rs. 3.9 billion to the National Exchequer during the year under review. This comprises income tax, sales tax, custom duties and other taxes.

Future Prospects

The company has a far-sighted plan for sustainable operations. **In line with this plan during the year, the Company launched an expansion project at an approximate cost of Rs. 3 billion, to enhance its cold rolling capacity and add a second galvanizing line.** These expansion projects were planned at the conceptual stage of ISL and foundations of the reversing mill constructed to incorporate the 'second stand', which at a fraction of the cost of the mill and with no additional operational man-power would lead to a 50% to 60% increase in capacity. Adequate space for the 2nd galvanizing plant was provided for in the master plan and we are confident to bring this on stream within the year 2014-15.

The expansion is expected to be completed in 2015-16, wherein the Cold Rolling capacity of your Company

would exceed to 450,000 tons of premium flat steel products. The galvanizing capacity is also being enhanced with the addition of a second line.

We have been successful in establishing our name as the preferred product in the local market commanding a premium as well as creating a niche in selected international markets. **The most significant challenge remains the pressure on domestic margins due to under invoiced imports; import of secondary quality material under SROs; smuggling and China FTA. The management continues to raise this issue at all appropriate forums and is hopeful that the government will consider this matter fairly and favorably.**

Acknowledgement

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

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

Kemal Shoaib

Chairman

Karachi : 12 August, 2014

