

Directors' Report



The Directors of International Steels Limited are pleased to present the 8th Annual Report accompanied by the audited accounts for the financial year ended June 30, 2015.

Global Steel Scenario

World crude steel production in the first six months of 2015 was lower by 2.0% compared to the same period of 2014. Prices within the global steel industry continuously declined as there was excess steel manufacturing capacity, particularly in China that produces over 50% of the world's steel output. The industry itself is incumbent with outdated technology, fragmentation and over capacity issues. This 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.

Pakistan's Economy

Pakistan economy has grown by 4.2% during fiscal year 2015. The industrial sector missed its target due to lower growth in Large Scale Manufacturing (LSM) and electricity generation. Activities in construction and mining and quarrying remained buoyant.

Improvements in macroeconomic indicators led SBP to continue with its expansionary monetary policy and enable it to reduce the policy rate by a cumulative 300 bps in FY15 to 7%, the lowest in many years.

In addition to this, narrowing of fiscal deficit and continuation of Extended Fund Facility (EFF) improved the external account and market sentiments.

These developments in recent months led to an upgrade of Pakistan's sovereign ratings by international rating agencies. Macroeconomic stability thus achieved should reflect positively on real economic activity going forward.

The Government is today facing numerous challenges including a power crisis, law and order issues in particular. It 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 the steel and allied industries.

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

Consumption of Flat steel products have grown by 11.5% in Pakistan, of this Cold Rolled Coils and Galvanized Coils grew by 12.3% & 9.3% respectively. Unfortunately your Company share in this market did not grow owing to imports under FTA with China and the levying of Import duty of our Raw materials that was exempt till 1st July 2014.

At the beginning of the financial year under review, duty allowed under SRO 565 on imports of cold rolled and galvanized coils was withdrawn however 5% import duty was imposed on our raw material. The country has a Free Trade Agreement (FTA) with China, which results in almost 70% of the imports of finished goods that we produce being made from China at a concessional rate of duty. Consequently, the company continued to face a severe challenge as the raw material that we import and finished goods that we produce are charged duty at the same level, which resulted in severe injury to local industry which had to operate with virtually no protection.

During January 2015, this issue was partly addressed through imposition of 5% regulatory duty on cold rolled and galvanized coils and sheets. The benefit of this measure was felt from March when the duty free material imported earlier was exhausted.

The above situation posed serious pressure on profitability for the first nine months and the company managed to remain at break-even position through cost curtailment, manufacturing efficiencies and wastage reduction.

Your Company's case for a level playing field for locally manufactured Flat Steel Products is being regularly placed at the highest levels in the Ministry of Commerce, FBR, Pakistan Customs, National Tariff Commission 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 at large.

The company also re-aligned its procurement strategy for sourcing raw material in a volatile market from diversified and reliable supply sources.

Our product quality enabled us to enter and establish our brand not only in the local but also in the export markets of South Africa, West Indies, Sri Lanka, United Arab Emirates, Jordan, Saudi Arabia, and Afghanistan. In addition, careful consideration was given to quality control as well as safety & environmental measures. Particular attention was paid to customer service via customized engagement in the backdrop of product development with significant engagements with the customers.

Manufacturing Operations

During 2014-15 production of the 4 Hi Mill was 238,640 tons, lower than last year by 15% primarily due to 5 weeks shut down owing to installation and commissioning of an expansion of rolling mill capacity. This production included approximately 169,000 tons of Galvanized Steel and 70,000 tons of Cold Rolled products.

Sales

During 2014-15, sales volumes were lower by 7% over the preceding financial year primarily owing to the stiff competition from low priced imports at concessional or no duty, as explained in detail earlier. The net sales value however was lower by 16% owing to sharp decline in steel prices globally.

Your Company continued to consolidate and leverage its nation-wide dealer network, which has been integral in reaching smaller commercial 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 remains amongst the cheapest by any I.P.P. in the country.

The management has invested Rs. 85 million in installing a 132 KV interconnection to replace the 11 KV and overcome the frequent tripping. The production of electricity remained at last year's level.

Health, Safety & Environment

In line with our objective in being an organization that does not harm people or the environment your company implemented and followed rigorous safety standards. The expansion project was completed without a major accident or a loss time incident. We ensured compliance to environmental standards and best practices for air emissions, noise, drinking water and industrial effluent in line with National Environmental Quality standards (NEQ's).

Human Resource

The Company continued its operations with an optimal headcount. The headcount at end 2014-15 was 532.

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 analyze 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 year were Rs. 17.94 billion, lower by 16% compared to 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. 1,485 million at 8.3% to net sales as against 10.6% last Year. This was, however, adversely impacted by lower PKR / USD parity in the second half of the year, thereby, placing pressure on margins to cover inventory purchased at the higher exchange rate in first quarter. Despite this, your Company has recorded a profit before and after tax of Rs. 236 million and Rs. 202 million respectively as against Rs. 874 million and Rs. 690 million last year.

Considering the lower profit for the year compared to last year and new expansion projects, financed through long term debts, no dividend is declared for the year 2014-15.

Earnings per share at June 30, 2015 was Rs. 0.46 as opposed to Rs.1.59 per share at June 30, 2014

Your Company is focused on improved working capital and cash flow management. During Fiscal 2014-15, your company generated a net cash flow from operations of Rs. 1,498 million. Rs. 750 million of this was used to repay long-term debts.

Contribution to National Exchequer and the Economy

The Company made a contribution of Rs. 3.86 billion to the National Exchequer during the year under review. This comprises income tax, sales tax, custom duties and other taxes.

Future Prospects

During the year, the Company launched major expansion projects valued over Rs. 3 billion.

- The addition of a second stand on the 4 Hi Reversing Mill converting it to Continuous Compact Mill and virtually doubling capacity.
- Installation of a 2nd galvanizing plant with a capacity of 250,000 tons and a thickness up to 2.0 mm

The Galvanizing plant was commissioned in early July 2015 and has increased production gradually so that Insh Allah it will reach full capacity by the end of the month.

Similarly, the second stand of 4 Hi Reversing mill was commissioned late July and is increasing production levels so that Insh Allah it will reach full capacity by early September 2015

- A color coating line was successfully commissioned during quarter 3, becoming first in the country to produce color coated steel sheets, providing significant import substitution. This will help in attracting high end product manufacturers.

In addition, your company has approached government and relevant institutions to rationalize import duties on raw material and finished goods that we produce which, when happens, would lay a very strong foundation to company's sustainable growth and higher contribution to the national exchequer. The management is hopeful that the government will consider this matter fairly and favorably.

Currently, the most significant challenge remains the pressure on domestic margins due to anomaly in duty structure, particularly from China under 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.



Kemal Shoaib
Chairman
Karachi : 13 August, 2015

Appointment of Chief Executive Officer and Advisor

Mr. Towfiq H. Chinoy has retired as Managing Director of the Company effective August 13, 2015. He served the group for 51 years, of these 37 years as Managing Director. He is the principal architect behind the formation of International Steels Limited and has been with the Company as Managing Director since its inception. It is under his visionary leadership that your company has grown into one of the leading companies in Pakistan's steel sector. He has been invited and has agreed to continue his strategic engagement as an Advisor and continue to be a Director of the Company

In his place, Mr. Yousuf H. Mirza has been appointed as CEO w.e.f. August 14, 2015. He joined the Company as the Chief Operating Officer in 2013, after leading Linde Pakistan for over 3 years as CEO. He has vast and diversified international business experience in manufacturing.

We are confident that your company will benefit from this enhancement in the management.

The necessary notice for shareholders' information under section 218 of the Companies Ordinance 1984 is appended on page 95 of this report.

Acknowledgement

The Board would like to thank all of their stakeholders, employees, customers, suppliers, shareholders, bankers and all others for their support and loyalty. Such support is required 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 sustain and grow over the years.

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