Directors' Report

The Directors of International Steels Limited are pleased to present the 9th Annual Report and audited financial statements for the year ended June 30, 2016.

Global Steel Scenario

World crude steel production dropped 3.0% compared to the previous year at 1.62 billion metric tons (MT). The Chinese steel industry accounted for approximately half at 804 million MT. Global steel prices declined between July and September 2015 and remained stable for the remainder of the year. As a result of aggressive trading of steel futures in China, prices increased in the first quarter of 2016 to peak in April, after which they declined sharply.

Pakistan's Economy

Pakistan experienced 4.7% economic growth during fiscal year 2016 (FY16), while the industrial sector achieved a growth of 6.8%. This was an all-time high compared to the last eight years. The Large Scale Manufacturing (LSM) Sector, which contributes 80.0% to the manufacturing and 51.8% to the industrial sector, also registered an impressive growth of 4.7%. The construction sector remained strong and supported allied industries such as cement, paint and steel.

Improvements in macroeconomic indicators led the State Bank of Pakistan to continue an expansionary monetary policy at the reduced policy rate of 5.75%, a 125 basis points drop over financial year 2016. Additionally, there was a decrease in the fiscal deficit; a continuation of Extended Fund Facility improved the external account and market sentiments. These developments have led to an improvement in Pakistan's sovereign ratings. The relative macroeconomic stability achieved should reflect positively on real economic activity going forward.

The cost of doing business decreased due to reduced petroleum product prices, low single digit inflation, low borrowing rates, expectations of better economic conditions following the China Pakistan Economic Corridor and ongoing energy projects. These factors have also boosted the confidence of the business community and enhanced investment.

Currently, Pakistan's government faces numerous challenges including alleviating a power crisis and maintaining law and order. The monetary deficits of this government caused by inadequate tax collection have been financed by borrowings from the banks which in turn have used their deposits as well as massive liquidity injection by the State Bank. Thus the private sector is being crowded out and severe distortions are being introduced in the monetary structure of the country. It seems to be focusing on public development schemes, for example the China Pakistan Economic Corridor, or highways and dams. These projects are likely to create demand for the construction and therein the steel industry.

Government policies on imports, particularly those pertaining to protection of the local manufacturing sector need to be revisited. The Free Trade Agreements (FTA) and proposed Most Favourable Nation (MFN) status should be reviewed to enable domestic manufacturers to meet a greater share of the country's demand.

Business Review

Over the financial year 2016 there has been a 16% increase in the consumption of cold rolled steel and 14% in galvanized products in Pakistan. Your Company's sales grew by over 50% following successful completion of the expansion project.

During the first half of the year, ISL faced a big challenge due to falling international steel prices and the continued influx of under invoiced and cheaper imports particularly from China under FTA. In order to remain competitive, the Company reduced its selling prices twice in the first half of the year, which affected profitability severely.

The Company filed an application before the National Tariff Commission (NTC) against the dumping of galvanized coils from China. However, before the NTC could make a decision on our application, the Islamabad High Court granted a Stay Order in January 2016 in favour of the importers and restrained the NTC from taking any action. The Company joined the case as an Intervenor after which the Stay Order was vacated. Simultaneously, however, the constitution of the NTC was challenged in Lahore High Court, which prevented the NTC from proceeding further. Reconstitution of the NTC is under progress.

Your Company's case to protect locally manufactured flat steel products is being regularly placed at the highest levels in the Ministry of Commerce, FBR, Pakistan Customs, NTC 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 benefit not only the local industry but also the country at large.

The Company also realigned its procurement strategy for sourcing raw material to diversified and reliable supply sources in a volatile market. Our product quality enabled us to enter and establish our brand internationally. We give careful consideration to quality control, safety & environmental measures and customer service via customized engagement.

Manufacturing Operations

During the year, the newly modified twin stand cold rolling mill and second galvanizing line were inaugurated by Dr. Miftah Ismail, Chairman Board of Investment. As a result of this expansion, the 4 Hi Mill produced 371,000 MT, a 55% increase compared to the last financial year. This production included approximately 118,000 MT of cold rolled products and 253,000 MT of galvanized steel.

Sales

During 2015-16, sales volumes increased by 52% exceeding 364,000 MT of prime products. This included 240,000 MT of galvanized and 124,000 MT of cold rolled products. The net sales value, however, increased by 14% due to the decline in steel prices and competition from low priced imports from China and Russia

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

Sale of Electricity to K- Electric

The Company's 19 Megawatt Power Plant continued to operate satisfactorily and in line with our practice we continued to supply excess energy to K-Electric. Sales to K-Electric showed a decline due to increased internal consumption as a result of higher output. Over the current financial year, on the completion of 60,000 hours of operation the Company will undertake a major scheduled overhaul of generator sets.

Health, Safety & Environment

In line with our aim to be a socially and environmentally responsible organization, ISL implemented and followed rigorous safety standards. The expansion project was completed without a single major accident or a lost time incident. We ensured compliance with environmental standards, best practices for air emissions, noise, potable water and industrial effluent in line with the national environmental quality standards.

Human Resource

The Company continued its operations with an optimal headcount. Despite the expansion, the headcount at the year-end 2016 increased nominally to 570 as compared to 532 at the end of the previous year.

The Company maintained industrial peace and a positive work environment for all employees in the organization. ISL continues its efforts to develop its personnel at all levels, proactively building capabilities and retaining talent for business continuity.

Risk Management

The Board meets frequently throughout the year to monitor and refine the Company's risk management policies. These 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 adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and ISL'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 increased by 14.0% to Rs. 20.5 billion. Despite continued pressure on profit margins owing to volatile global steel prices and competition from under invoiced and secondary materials being imported into the country, gross profit was Rs. 2,913 million. The gross profit margin improved to 14.2% of net sales compared to 8.3% last year due primarily to lower steel prices and better absorption of fixed costs, given the significant increase in volumes during the financial year.

Administrative expenses were strictly controlled and decreased by 3.9% to Rs. 161 million. Selling and distribution expenses increased by 23.3% primarily due to higher freight & forwarding charges and sales promotion activities.

Financial charges reduced by 28.9% to Rs. 732 million on account of mainly a lower mark-up rate on borrowings, better cash management and lower foreign exchange losses. Other operating expenses at Rs. 264.7 million were significantly higher than last year due to higher workers profit participation and workers welfare funds (directly related to profit).

Overall, ISL posted a record profit before and after taxation of Rs. 1,654 and Rs. 1,179 million (Rs. 2.71 per share) respectively compared with Rs. 236 million and Rs. 202 million (Rs. 0.46 per share) last year.

Your Company is focused on improving working capital and cash flow. During the year, your company generated a net cash flow from operations of Rs. 2,872 million, an increase of Rs. 1, 373 million compared to last year.

Dividend

Keeping in view the financial results of the Company, the Board of Directors has recommended a 12.50% cash dividend.

Contribution to National Exchequer and the Economy

Your Company made a contribution of Rs. 4.73 billion (compared to Rs. 3.86 billion last year) **to the national exchequer during the year** by way of income tax, sales tax, custom duties and other levies.

Changes in the Board of Directors

During the year, Mr. Otomichi Yano resigned as a director of the Company and was replaced by Mr. Kazuteru Mihara. The Board wishes to place on record its appreciation for the valuable services rendered by Mr. Yano during his tenure. We welcome Mr. Mihara, who will hold office for the remainder of the term of the outgoing director.

Future Prospects

Your Company has launched a new expansion project valued at over Rs. 250 million aimed at removing the bottleneck at its pickling line. The project, once completed, will enhance the rolling capacity to 600,000 MT per annum.

ISL has approached Pakistan's government and other relevant institutions to rationalize import duties on raw material and finished goods that we produce. Once rationalized, these policies would lay a very strong foundation to sustainable growth and a higher contribution to the national exchequer. Our applications for antidumping duties on cold rolled and galvanized coils are also at the final stages of consideration by the NTC. The management is hopeful that these matters, which are supportive of local industry, will be considered fairly and favorably.

Significant challenges lie ahead considering the volatility in global raw material prices and the difficult business environment your Company is operating in.

Acknowledgement

The Board would like to thank all of their stakeholders, employees, customers, suppliers, shareholders and bankers for their support and loyalty. Such support is required not only to meet normal commercial challenges but also to meet those challenges posed by security issues and tough economic conditions. The confidence and goodwill of the stakeholders has allowed the Company to achieve sustainable growth over the years.

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

Kemal Shoaib
Chairman

Karachi
12 August 2016