Directors' Report

The Directors of International Steels Limited are pleased to present the 10th Annual Report accompanied by the audited financial statements for the year ended June 30, 2017.

Global Steel Scenario

World crude steel production touched 1.63 billion metric tons during the year, which is almost equal to the last year's production. China produced about 50% of global steel output at 808 million metric tons. On the demand side, metal consumption in China rebounded in response to the authorities' policies in support of credit growth, resulting in price stability.

Pakistan's Economy

On an overall basis, the country's economic fundamentals looked strong with the highest GDP growth rate of 5.3% in the last ten years. Industrial sector recorded a growth of 5.02% as compared to 5.80% last year. Large Scale Manufacturing (LSM) with the share of 51.26% in industrial sector posted growth of 5.1% against 4.6% last year. The construction sector continued to raise its share in GDP to 2.74% from last year's 2.65% supporting other allied industries including the steel industry.

Specific data shows that Iron & Steel products recorded the highest growth of 16.58% compared to a negative growth of 7.48% last year. Flat steel products grew by 12%. Robust construction activities mainly led to an increase in demand for steel and allied products. The improved energy supply as well as industry gained some comfort after recovery in global prices which provided room to local players to increase their prices which ultimately helped them to enhance their capacity utilization.

The macro-economic fundamentals during the fiscal year remained strong which lead to SBP to maintain the last years' policy rate of 5.75%. Ongoing stability in money market are the main instruments for private sector credit cycle for fixed investment and for working capital adding positives to the enabling business environment of the country. Furthermore, elevation of Pakistan by the Morgan Stanley Capital International (MSCI) from the status of Frontier Markets to Emerging Markets also indicates positive developments for Pakistan's economy. Overall encouraging signs about the economy and its revival are mainly attributable to CPEC (China Pakistan Economic Corridor), ongoing energy projects and improved security situation.

Beneath the surface of the growing economy, some threatening signals are also evolving which are mainly attributable to structural holdups within Pakistan combined with low growth in destination markets resulted in weakened textile exports. Remittances are also starting to taper off, declining for the first time in over a decade. This was largely driven by deteriorating economic conditions in GCC countries, which account for almost two-thirds of Pakistan's remittances. Privatisation efforts have stalled, which has also affected the broader reform efforts in the electricity sector, with the resurgence of circular debt. However, the government's increased focus on infrastructure has resulted in the initiation of a series of development projects during the last two years. These include foreign funded projects. Given the critical role of steel in the development of roads, railway, dams and power infrastructure, as well as the current pace of development projects being pursued in the country, the demand for steel and allied products is expected to increase significantly. Furthermore, Pakistan needs a clear and consistent policy which should identify segments in the steel chain that need protection to ensure fair competition in the market. This policy should also consider the level of protection available to steel manufacturers in Pakistan's competitors, especially China.

Business Review

Over 2017, the flat steel products reflected a growth of 12%. Your company's sales grew by 35% following successful execution of de-bottle necking project for the pickling line.

The National Tariff Commission (NTC) imposed anti-dumping duties on cold rolled and galvanized sheets from China and Ukraine. The duties for cold rolled ranged from 13.17% - 19.04% and for GP 6.09% - 40.47%. The NTC decisions were challenged in Lahore High Court and were finally dismissed in May 2017. The company expects that the enforcement of Anti-Dumping duties will create a level playing field for local manufacturers.

The company was also recognized as a local manufacturer of cold rolled and galvanized steel under CGO 02/2017 resulting in applicability of all the exemptions/concessionary notifications from customs duties and sales tax.

Manufacturing Operations

The company successfully completed a debottlenecking project for pickling line thereby taking cold rolling capacity to 550,000 tons. Current year production was 464,000 tons, reflecting an increase of 25% over the previous year. Various productivity based initiatives resulted in increased plant reliability and operational efficiencies.

Sales

The company maintained its growth momentum exhibited a substantial increase of 35% in volumes over the preceding financial year exceeding 491,000 metric tons of prime products comprising 300,000 metric tons of Galvanized and 191,000 metric tons of Cold Rolled Products despite the influx of low priced imports primarily from China and Russia. The net sales value also increased by 65% mainly due to stable global steel prices.

The 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 production of electricity remained at last year's level. The Company has undertaken a major overhaul of the Generator Sets which will further enhance the efficiency of the power plant.

Health, Safety & Environment

Implementation of rigorous safety and environmental standards and strong management focus, no major incident was reported and the on-going expansion project has continued without a loss time incident. We ensured compliance with environmental standards, best practices for air emissions, noise, portable water and industrial effluent in line with the national environmental quality standards.

Human Resources

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.

All the Human Resource related aspects viz. remuneration, allowances, benefits, performance appraisals, working conditions etc. are governed under robust HR related policies and procedures, overseen by a dedicated Human Resource department.

The Company successfully continued its operations with an optimal headcount. The headcount at year end 2016-17 was 567 compared with 570 of the previous year.

Risk Management

The Risk Management Infrastructure of the company is based upon Enterprise Risk Management methodology/framework addressing the major risk categories including Strategic, Operational, Compliance and Financial Reporting Risk.

Adequate controls, manual as well as automated, have been designed and communicated to the staff via various policy and procedural guidelines which are executed and self-assessed by the process/control owners.

An independent Internal Audit Department, under direct reporting to the Board Audit Committee, evaluates and oversees the design and operating effectiveness of these controls.

Financials

The Company continued its growth momentum in the current year resulting an increase of 65% (Rs. 33.7 billion) in Net sales. The Gross Margins stood at Rs. 5.9 billion (17.5%) compared with Rs. 2.9 billion (14.2%) in the same period last year despite the under invoiced and secondary grade materials being imported into the country. The company's improvement in gross margins was attributable to building of operational efficiencies, reaping economies of scale and controlling unproductive costs.

Administrative expenses were well contained at Rs. 215 million whereas, Selling and Freight expenses were increased by 61%, which was in line with increased sales volume for the current year.

Other operating expenses at Rs. 424.9 million were significantly higher than last year primarily due to higher WPPF and WWF charges (which were directly related to profit). Financial charges recorded at Rs. 456 million depicted a reduction of 37.7% mainly due to lower mark up on borrowings which was a result of better cash flows coupled with a lower exchange loss on FE financing.

Overall your Company posted a record profit before and after taxation of Rs. 4,609 million and Rs. 3,044 million respectively compared with Rs. 1,654 million and Rs. 1,179 million last year. Your Company is focused on improving working capital and cash flow management. During the year, your company generated a net cash flow from operations of Rs. 1,569 million, a decrease of Rs. 1,032 million over last year, due to high volumes of stock in transit. An interim dividend of Rs. 1,088 million (Rs 2.5 per share) was paid during the year.

Earnings per share

Earnings per share for the year ended June 30, 2017 was Rs. 7.00 compared with Rs. 2.71 per share last year.

Dividend

In view of the financial results of the Company for the year 2016-17, the Board of Directors of the Company has recommended a cash dividend of 10% i.e., Rs. 1.00 per share in addition to 25% interim cash dividend announced and paid, making a total dividend payout of Rs. 3.50 (35%) per share for the financial year ended June 30, 2017.

Contribution to National Exchequer and the Economy

Your Company made a contribution of Rs. 7,220 million to the National Exchequer during the year by way of income tax, sales tax, custom duties and other levies.

Provident Fund & Gratuity Scheme

The Company provides retirement benefits to its employees. These include a non-contributory defined benefit Gratuity Scheme for all employees and a contributory Provident Fund for all employees except unionised staff. Both plans are funded schemes recognised by tax authorities.

The values of the Provident Fund and the Gratuity Scheme at the year end were Rs. 114.40 million and Rs. 75.18 million.

Future Prospects

The company announced an investment of Rs.5.6 billion to increase its cold rolling capacity by 500,000 tons to 1 million tons. The project involves cold rolling mill, a continuous pickling line and expansion in annealing capacity. The expanded capacity will cater for the robust growth in the industrial sector. Company expects the project to be commissioned during the next financial year under review.

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 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.

Yousuf H. Mirza
Chief Executive Officer
Karachi: 15th August 2017