Directors' Report

The Directors of International Steels Limited are pleased to present the 13th Annual Report accompanied by the audited financial statements for the year ended June 30, 2020.

Boards Composition & Remuneration

Composition of the Board and the names of Members of Board Sub-committees may be referred at Page No. 64 & 76. The company has a formal policy and transparent procedures for remuneration of its Directors in accordance with the Companies Act, 2017 and the Listed Companies (Code of Corporate Governance) Regulations, 2019.

The remuneration, including the Directors fee for attending the board meetings paid to the Directors and Chief Executive Officer is disclosed on Page 147 (Note 32 financial statements).

Global Steel Scenario

World crude steel production declined slightly by 2% to remain at 1.8 billion metric tons during the year, as compared to the last year's production of 1.83 billion metric tons. China continued to dominate the global steel market by increasing its share in the global output from 53% in 2019 to around 56% in 2020.

The outbreak of COVID-19, novel coronavirus, in the last quarter of the FY 2020 impacted almost all industries and sectors worldwide; two of the most impacted ones were manufacturing and travel & transportation. The major steel producing countries were already persisting with their protectionist measures. Foremost being the United States continuing with 25% duty on steel imports from around the world. Despite the decline in the global steel production, Chinese steel production grew by 3.4% crossing the 1 billion metric tons mark for the first time. China's surging production is largely due to its capacity replacement program though its pace slowed down in the FY 2020 as compared to the last year. Growth in real estate sector and infrastructure stimulated the overall increase in consumption of steel products. However, the outbreak of novel coronavirus affected the steel demand in China since December 2019.

EU steel demand suffered a contraction of 5.6% in FY2020 due to the sustained manufacturing recession. US is also witnessing a sharp manufacturing recession amidst COVID-19. Surging unemployment, reduced income and confidence have impaired residential construction, which will have a further damaging effect on the steel demand.

The developing economies are less equipped to tackle COVID-19 making their recovery and return to normalization more difficult. Limited fiscal space to support the economy, a fall in commodity prices, capital flight and currency depreciation render the decline of steel demand in some developing countries as severe as that in developed economies.

Pakistan's Economy

The business environment in the FY 2020 was generally unfavorable. The first half of the fiscal year was marred by inflationary pressure, depressed spending power due to higher policy rates and austerity measures on account of fiscal reforms, leading to suppressed economic activity. The large-scale manufacturing was down by 10.2% as compared to last year leading to significantly reduced business activity across all segments of the economy. The situation was further exacerbated by the COVID-19 pandemic. The complete lockdown brought the whole economy to a standstill and with the same lockdown across the globe, international trade, travel and business activity declined significantly.

Pakistan managed to contain the devastating effects of the COVID-19 through its lockdown strategy. The State Bank of Pakistan (SBP) responded to the crisis by cutting the policy rate by a cumulative 625 basis points to 7.0 percent since March 2020. However, the rate remained as high as 13.25% for better part of the year.

The GDP growth rate went into negative by 0.4%. Exchange rate further depreciated by 2.6% during FY2020 on the back of a cumulative depreciation of 34% during FY2019. Headline inflation recorded at 11.22% during Jul-Apr FY2020 as against 6.51% during the same period last year. Rose to as high as 14.6% in January 2020 but fell to 8.5% in April 2020. However, some positive results of the Government's macro-economic reforms, particularly in the Current Account Deficit, which narrowed 77.9 % to $2.97 billion in July-June FY2020 from $13.43 billion in the previous year, equivalent to 1.1% of GDP as compared to 4.8% of GDP during the last year. Remittances have also increased supporting the foreign exchange reserves.

Steel demand in the country contracted from a further decline of 36.5% in automobile production along with international price dynamics. At the same time, cuts in development spending and a general slowdown in economic activities coupled with COVID-19 outbreak reduced the demand for iron and steel urging the local steel industry to curtail their production. All these factors contributed to the negative growth of 8% in iron and steel industry. Nevertheless, the COVID-19 pandemic is presenting a fair few short-term challenges to the steel industry. The quickening recovery in the country indicates that the industry should be able to weather this storm.

Manufacturing Operations

Current year production was 412,000 tons, reflecting a decrease of 26% over the previous year based on subdued demand and shutdowns relating to gas shortages in winter months and COVID-19 pandemic.

Sales

To counter the domestic weak demand, your company carried out aggressive market development activities, focusing on new, untapped and emergent opportunities, in wake of global socioeconomic conditions and changing global trade dynamics due to growing protectionism against traditional suppliers. As a result, the company managed to achieve 1.3 times higher export sales as compared to last year. However, the overall sales value declined by 16% at Rs. 48.1 billion as compared to the last year's sales of Rs. 57.5 billion.

The gross margin remained under pressure due to fluctuations in exchange rate and volatility in international steel prices. The finance cost for the year increased sharply mainly due to extremely high interest rates in the first 9 months of the year.

Effected by economic slow-down and COVID-19 pandemic, the Company saw a dip in its overall sales volumes mainly witnessed in the Galvanized sales which decreased by 23% whereas the sales volumes of Cold Rolled Products decreased by 17%. The total sales volumes of the prime product remained at 418,000 metric tons comprising 237,500 metric tons of Galvanized and 180,500 metric tons of Cold Rolled Products. The Company continued to consolidate and leverage its nation-wide dealer network, however special focus has remained on exploring and developing the export markets.

JCR-VIS Credit Rating

In 2019, the Company was last awarded the rating of 'A+/A-1' (Single A Plus / A – One) by JCR-VIS Credit Rating Company Limited. Outlook assigned to the rating was 'Stable'.

Energy Management

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.

Health, Safety & Environment

Company believes in and is fully committed to improve Health, Safety and Environment standards to achieve sustainable HSE performance. Process Safety & Behavior Based Safety across the organization is ensured through HSE Management System integrated with the company's organization scheme and the Company is on track of continuous improvement with focus to achieve & sustain leading levels. The Company conducts training and awareness sessions on behavior based safety to create a sustainable and safe working environment for our people, customers and contractors.

Your Company was quick to implement the Standard Operating Procedures (SOPs) to combat COVID-19. The Company continued its operations during the pandemic with strict adherence to the SOPs. 77 staff members were tested showing symptoms of COVID-19 out of which 25 came positive. The Company provided full medical and financial assistance to them and they have completely recovered.

Implementation of focused safety programs, environmental standards and strong visible leadership resulted yet another year without any major incidents. Your company continued to comply with National Environmental Quality Standards including best practices for air emissions, noise, portable water and industrial effluent.

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. The Company continues its efforts on development of personnel at all levels, proactively building capabilities and retaining talent for business continuity. Employee engagement has been managed with robust policies and procedures. The state of the art gymnasium was inaugurated to encourage employees to adapt a healthy life style.

The Company has formulated a firm succession plan, which includes performance evaluation and appropriate training requirements for development of potential future leaders. The Company continued to enhance capabilities of employees by providing them development opportunities internationally as well as at prestigious institutions like LUMS, IBA, ICAP and Management Association of Pakistan.

The Company successfully continued its operations with an optimal headcount of 692. Despite facing the COVID-19 crisis with less encouraging financial results this year, the Company did not lay off any of its employees.

Corporate Social Responsibility

The Company believes in supporting the community and has a policy to contribute at least 1.5% of its profit after tax. Despite having low profits this year, the Company donated Rs. 19.2 million, constituting a much higher percentage of its profits to various organizations in the areas of healthcare and education including The Citizen Foundation, AAS Trust, Karachi Relief Trust, Karwan-e-Hayat, Al-Rehmat Benevolent Trust and Hunar Foundation. Major amount of this total donation was given in relation to the COVID-19 relief efforts of the Government.

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 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.

Business Review

In 2020, the Company targeted to maintain its growth streak but saw a decline in its production and sales. The Company posted the revenue of Rs. 48.1 billion against Rs. 57.5 billion last year. The rolling production during the year was 424,300 tons against 584,400 tons last year. Whereas, the total saleable production was 412,000 tons as compared to 555,000 tons of last year. The profit margins remained under pressure due to the increased international steel prices coupled with the unprecedented volatility in the exchange rates and hike in the interest rates. The gross margin reduced to 8.8% from 11.2% last year because of Supreme Court decision on Gas Infrastructure Development Cess (GIDC) due to which Rs. 1,240 million of GIDC was recognized against the self-consumption out of which Rs. 224 million was additionally provided during the year. However, GIDC component of Rs. 737 million against K-Electric recognized as contingent liability. This amount is recoverable form the utility provider during the course of next 24 months. The Company posted profit before tax of Rs. 443 million and profit after tax of Rs. 495 million against profit before tax of Rs. 3,679 million and profit after tax of Rs. 2,664 million last year.

The new installed capacity of Compact Cold Rolling doubling the existing rolling capacity of the Company to 1,000,000 tons, but could not be utilized fully due to the dampened demand and an overall slow down in the local market. Nevertheless, the enhanced production capacity has enabled the Company to increase its market share with fulfilling the demand in local and international markets and helping the economy in terms of import substitution.

The increased focus with a well-marked strategy to target the export markets yielded positive results increasing the Company's export sales by 1.3 times to Rs. 9 billion as compared to Rs. 3.97 billion of export sales last year. The export volumes have also gone up from last year's 34,700 tons to 84,250 tons.

Financials

The Company had witnessed negative growth in the current year's revenue collection of Rs. 48.1 billion, which is 16% lower than last year. The gross margins stood at Rs. 4,213 million compared with Rs. 6,449 million last year.

Administrative expenses reduced to Rs. 263 million as compared to the administrative expenses of last year of Rs. 284 million. Selling and freight expenses increased by 27%, due to increased focus and investment on exports and the marketing activities.

Other operating expenses reduced to Rs. 334 million as compared to the last year's expenses of Rs. 534 million. Financial charges increased by 80% and stood at Rs. 2,315 million mainly due to hike in the interest rates and massive depreciation of PKR against the USD, resulting in higher financing requirements.

Overall your Company is focused on improving working capital and cash flow management. However, the interest payments declined the net cash generated from operations to Rs. 1,968 million, a decrease of Rs. 1,518 million from last year.

Earnings per share

Earnings per share for the year ended June 30, 2020 was Rs. 1.14 compared with Rs. 6.12 per share last year.

Dividend

Due to current economic conditions and business challenges the Company has decided to preserve cash in order to create more value for its shareholders and therefore not to pay any dividend for the year ended June 30, 2020.

Recommendation of the Board Audit Committee for appointment of auditor

The present external auditors M/s KPMG Taseer Hadi & Co., Chartered Accountants were appointed since FY 2010-11. The Management and the Board of Directors are grateful for their services which will end on the conclusion of the 13th Annual General Meeting which will be held on September 29, 2020. Board of Directors and Board Audit Committee have recommended M/s A.F. Ferguson & Co., Chartered Accountants for appointment as statutory auditors for the year 2020-21 at the prevailing fees of retiring auditors.

Appropriations

	2020	2019
	Rupees in '000	
Profit after tax for the year	**494,851**	2,664,373
Interim Dividend (2020 Rs. Nil per share; 2019 Rs. 1.5 per share)	-	(652,500)
Final Dividend (2020 Rs. Nil per share; 2019 Rs. 1.5 per share)	-	(652,500)

Contribution to National Exchequer and the Economy

Your Company made a contribution of Rs. 9,914 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 unionized staff. Both plans are funded schemes recognized by tax authorities.

The values of the provident fund and the gratuity scheme at the year end were Rs. 194.7 million and Rs. 192.9 million.

Future Prospects

The company operates with 1,000,000 tons of commercial production capacity of cold rolling. The new Compact Cold Rolling Mill is complemented by a new continuous pickling line, additional annealing furnaces and acid regeneration facility. The expanded capacity will enable your company to recapture its market share in the local and international markets and be instrumental in imports substitution. A dedicated service center has also become operational at the

Port Qasim Area of Karachi. The strategic location of the center is aimed at increasing the Company's value proposition and service offerings.

Recognition

Your company won the Best Export Performance Award in the Iron and Steel Products category at the 41st & 42nd Annual Export Awards Ceremony of FPCCI. For the first time, ISL made it in the list of top 25 companies announced by the Pakistan Stock Exchange. Recognising the company's adherence to the corporate governance best practices, the company was awarded the Management Association of Pakistan Corporate Excellence Award for the second consecutive year.

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 the Company and for the benefit of all stakeholders, and the country in general.

Yousuf H. Mirza
Chief Executive Officer

Towfiq H. Chinoy
Chairman

Karachi 25 August 2020