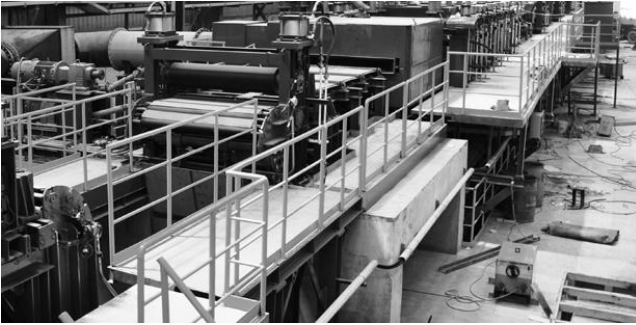


TUNDRA CASE



AISHA STEEL MILLS LIMITED
PAKISTAN

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INTRODUCTION

In early 2017, Aisha Steel Mills Limited (ASML) was bought on behalf of three of Tundra Fonder's funds. The first and only exposure in the steel market in Pakistan, ASML constitutes an interesting case study of a sustainable mid-sized steel company in the country. Factors such as continued economic growth in the country, an increased demand for steel, and regulations promoting domestic manufacturing created a favorable investment environment.

The iron and steel sector is one of the most energy-intensive in the world. With a global capacity of just over 1.6bn tonnes (2016), the sector relies heavily on water, energy and labour [1]. Materials needed to make steel include iron ore, coal, limestone and recycled steel. Steel production methods have evolved significantly since the steel industry first began in the late 19th century. Two processes dominate production: basic oxygen steelmaking and electric arc furnaces. Steel is 100% recyclable, and due to its magnetic properties easily separated from other waste [2]. Water use is intensive. Hot steel is cooled by water, which is also used for coke quenching, reactor cooling and hot rolling; water is also required to produce steam, tin plating and to clean ovens, blast or basic oxygen furnaces etc. [3]. The steel industry is also one of the top emitters of greenhouse gases. One tonne of steel produces nearly two tonnes of carbon dioxide (from a blast furnace) [4]. It is estimated that in 30 years, carbon dioxide emissions from this industry will equal approximately 2,800m tonnes per year [5]. In recent years, there is an increased focus on sustainability within the steel industry, especially in light of the Paris agreement. Steel producers are discussing the possibility of applying carbon costing mechanisms – applying a cost for emitters which encourages them to either reduce emissions or become more efficient – to reduce their carbon emissions and water consumption. Other than being environmentally taxing, the sector also carries significant worker health and safety risks. The International Labour Organisation (ILO) has a dedicated code of practice for health and safety in the steel industry [6].



Various stages of global steel production. Photos: World Steel News, National Geographic, Construction Week Online.

STEEL INDUSTRY IN PAKISTAN

Pakistan has a relatively small iron and steel industry which has a production capacity of approximately 3.6m tonnes from 350 mills across the country, as compared with leading global steel producers: China (808m tonnes), Japan, (104m tonnes) and India (96m tonnes) [7]. Some steel companies declare that barely 10% of the local production meets international quality standards; the rest is considered ungraded and untraceable [8]. As far as the steel industry's ESG profile is concerned, the results are mixed. While strict environmental and social laws exist, not all companies follow them. In Pakistan's capital, Islamabad, there have been several instances of residents complaining against emissions from steel mills that hinder day-to-day life in residential sectors. According to Pakistan's Environmental Protection Agency (Pak-EPA), offending companies are both uncooperative and exhibit a lack of seriousness about environmental sustainability.

This was true even after the Supreme Court of Pakistan took notice of environmental violations. In response to complaints from residents living in sectors I-9 and I-10 that smog hung heavily overhead and the air had reached difficult-to-breathe levels, the Supreme Court issued orders to shut down any steel mill in violation of environmental regulations. According to news reports, more than a dozen steel furnaces disregarded Pak-EPA's warnings to install equipment such as bag air filters and online dust monitors to reduce emissions. Even mills that had been sealed for non-compliance by the Pak-EPA resumed their activities without proper clearance [9].

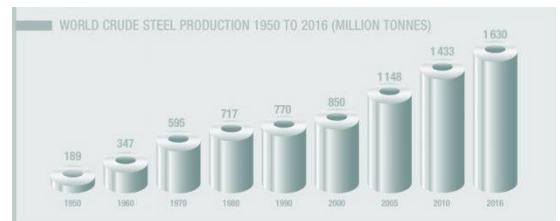
Water pollution is another important environmental concern in Pakistan. Industrial effluents from different sectors, including steel, contribute to escalating ground water pollution [10]. Additionally, Pakistan imports iron ore in order to manufacture steel. Ships bringing raw materials also contribute to the pollution.

Steel workers are exposed to poor working and living conditions. Mills that do not follow environmental regulations are also lax regarding worker safety working conditions. Workers often work in extremely high temperatures both day and night. A Pak-EPA monitoring team visited steel mills in Islamabad and discovered that workers lacked mandated protective equipment, and the sites did not meet health and safety standards [11]. Accommodation facilities are usually subpar. Wages are also low when compared to the amount and risky nature of work.

Reporting suggests issues of non-payment of workers' wages. This was the case two years ago in Pakistan Steel Mills – the largest steel manufacturing plant in Pakistan [12] – when workers were not paid their salaries for 4 months. A year before that the same had occurred for 3 months. Retired employees have also had tremendous problems receiving their gratuities and legal dues. After waiting to be paid (2008-2016) employees took Pakistan Steel Mills to court [13]. In April 2017, the Economic Coordination Committee approved the payment of Rs380m in salaries. [14].



A worker stands around heated steel during the rolling process. **Photo:** The Express Tribune.



World crude steel production 1950 to 2016. (m tonnes).

Source: World Steel Foundation

RATIONALE FOR TUNDRA'S INVESTMENT

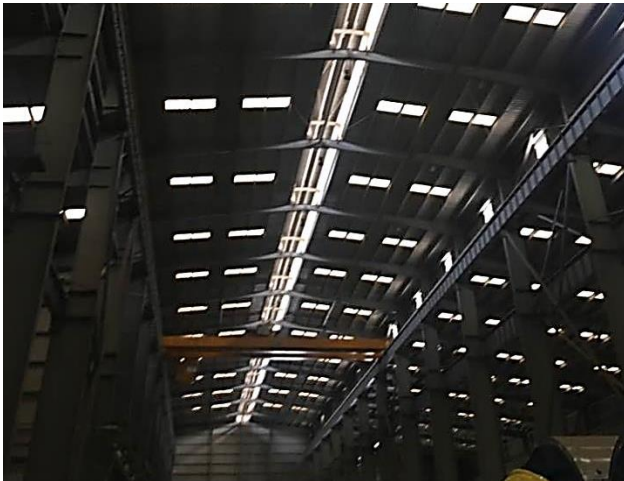
Pakistan has traditionally relied on the financially troubled, state-owned 'Pakistan Steel Mills' to cater to its flat steel product demand. However, frequent disruptions in production due to a liquidity crunch opened an avenue for the private sector to enter the steel sector. ASML is one of two companies manufacturing flat steel with a capacity of 220,000 tonnes (~27% market share). Pakistan's combined Cold Rolled (CR) and Galvanized Coil (GC) annual demand is estimated at 1.25m tonnes compared to production capacity of ~800,000 tonnes. The remaining demand is met by imports. As Pakistan's economy grows, rising demand for steel from white good manufacturers and auto assemblers is expected to reach 1.85m tonnes by 2022. Considering the significant level of imports and the growth prospect for flat steel, ASML has decided to expand its capacity by 2.2x to 0.7m tonnes (56% of current domestic demand). The upcoming expansion includes GC line, a value added product, which is expected to improve gross margins for the company going forward. In order to promote the local industry, National Tariff Commission of Pakistan imposed a five-year anti-dumping duty on low cost/low quality CR and GC from China and Ukraine in the range of 6% – 40%. A move which, has not only significantly increased the pricing power of domestic players (i.e. ASML), but is also expected to increase operating margins for the industry (20-22%). ASML, in an import substitution play, is set to deliver an additional 480,000 tonnes of flat steel to the domestic market by FY19. Furthermore, a favorable regulatory regime promoting domestic manufacturing is likely to increase profitability for the industry as a whole, and for Aisha Steel in turn.

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COMPANY FACTS AND ENGAGEMENT

Incorporated in 2005, Aisha Steel Mills Limited (ASML) is a cold rolled coil manufacturer. Hot rolled coils are imported as raw material for the final product. Several processes are carried out: pickling (removing black oxide scale from the surface), cold rolling (rolling hot rolled coils into thinner gauges as required), cleaning and batch annealing (cleaning the product of oil, iron powder and other foreign materials). Tundra’s Karachi team met with CEO, Dr. Munir, and CFO, Umair Noor Muhammad, at Aisha Steel offices in June for a detailed discussion about the company’s expansion and future projects. ASML believes in being sustainable because, according to the CEO, there is a strong demand for it from foreign investors. ASML is in the process of adopting ISO 9001 and ISO 14000 certifications. Since the company manufactures cold rolled coil and does not need to employ energy-intensive aspects of making steel such as melting the steel, the company performs well as a relatively environmentally-sound steel company. During the day-time visit, it was observed that instead of overhead lights, natural light is utilized through shutters installed in the factory roof.



Effective use of natural sunlight in the factory. Photo: Tundra

Where employees are concerned, the company claims that it is an equal opportunity employer providing jobs irrespective of gender, creed, religion etc. In 2016, ASML employed an average of 351 people, an increase of over 4% from 2015. CFO, Umair Muhammad, disclosed that factory workers made up nearly 80% of the employee population while the rest were desk and support staff. All employees are offered several trainings throughout the year: these include trainings on health and safety as well as general capacity development. Targeted trainings for mentoring promising employees are also carried out.



With the Aisha Steel Mills CEO and CFO. Photo: Tundra

According to Mr. Umair Muhammad, no serious accidents have occurred so far. mill workers are not subjected to risky or life-threatening activities and are limited to the process of pickling, cold rolling and cleaning, as mentioned earlier. There has been no instance of non-payment of salaries. He added that there was moderate employee turnover. This was largely because ASML is situated in a far-flung area and could take some employees up to two hours of commuting time each way. However, the company provides free of cost pick and drop services to its employees. Reportedly, the company also focuses on employing women engineers. The company engages in corporate philanthropy in the areas of healthcare, education and humanitarian relief. The company routinely participates in job fairs and organises recruitment drives for fresh graduates. ASML staff also participate in blood donation drives for Indus Hospital, a non-profit healthcare institution where treatment is free of charge for all patients.



Tour of the steel mill. Photo: Tundra

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