# RATING REPORT

# International Industries Limited (IIL)

**REPORT DATE:**
July 02, 2019

**RATING ANALYSTS:**
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| RATING DETAILS | | |
|---|---|---|
| **Rating Category** | **Latest Rating** | **Previous Rating** |
| **Entity** | **AA-/A-1** | **AA-/A-1** |
| ***Rating Date*** | *June 21, 2019* | *April 10, 2018* |
| **Rating Outlook** | Stable | Stable |
| ***Outlook Date*** | *June 21, 2019* | *April 10, 2018* |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1948** | **External auditors:** M/s KPMG Taseer Hadi & Co. |
| **Public Listed Company** | **Chairman of the Board:** Mr. Mustapha A. Chinoy |
| | **Chief Executive Officer:** Mr. Riyaz T. Chinoy |
| **Key Stakeholders (with stake 5% or more):** | |
| *Directors, CEO, Sponsors and Family Member - 50.3%* | |
| *Govt. Financial Institutions & Associates - 9.0%* | |
| *Banks, DFI & NBFI and Insurance Companies - 9.3%* | |
| *Mutual Funds - 6.5%* | |
| *General Public - 18.7%* | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria:** ***Corporates (May 2016)*** |
| https://www.vis.com.pk/kc-meth.aspx |

# International Industries Limited (IIL)

## OVERVIEW OF THE INSTITUTION

International Industries Limited (IIL) was incorporated in Pakistan in 1948 and is quoted on the Pakistan Stock Exchange (PSX). IIL is in the business of manufacturing and marketing of galvanized steel pipes, precision steel tubes, API line pipes and polymer pipes & fittings. During the year, IIL merged IIL Stainless Steel (Pvt) Limited into itself, which was a 100% wholly owned subsidiary. As at March 31, 2019, IIL's subsidiaries include International Steels Limited (ISL) and IIL Australia Pty. Limited along with an associate company namely Pakistan Cables Limited (PCL). IIL holds 17.124% shares of PCL.

## RATING RATIONALE

International Industries Limited (IIL) enjoys its position as a dominant market player in the steel industry. It is primarily engaged in the manufacturing of steel and polymer pipes and fittings with an annual manufacturing capacity of 741,200MT. During FY18, IIL also added two High Density Polyethylene (HDPE) extruders along with commissioning of Polypropylene Random Copolymer (PPRC) pipes and fittings factory in Sheikhupura, which contributed in sizeable volumetric growth in sales of Polymer segment. Moreover, two Stainless Steel tube mills and polishing machines were also added which contributed in growth of sales in this new segment. The company anticipates further capacity expansion in its polymer pipes segment for which it acquired a land of 122 kanals in Sheikhupura. IIL has in-house co-generation facilities, which are sufficient to cater to the power related needs of the company, and excess (if any) is supplied to utility companies.

### Business Risk

Steel sector is characterized by moderate business risk given the cyclical nature of the industry. During 9M2019, the industry faced significant volatility in steel prices where Hot Rolled Coil (HRC) prices hovered in the range of $500-620 per MT (FY18: $500-635; FY17: 370-570). HRC is a core imported raw material for the steel producers and the rupee depreciation over last one year has adversely impacted margins.

### Sales Mix

Revenue base of the company amounted to Rs. 25.0b (FY17: 16.7b), during FY18. Of its total sales, Rs. 22.8b was contributed by the steel segment while the remaining emanated from polymer segment. Growth in steel sales was on the back of higher demand of gas distribution pipes and demand from automobile industry. Sales mix of IIL largely comprises domestic sales volume representing 82% while remaining is from exports. While domestic sales volumes depicted significant growth (FY18: 221,245 MT, FY17: 147,423 MT), exports declined largely (FY18: 48,955 MT, FY17: 60,510 MT) because of import levies in Sri Lanka on steel pipes and increase in domestic production in Afghanistan. As a result of slowdown in local and global economy, management anticipates revenues to remain at same level in the ongoing year. During 9M2019, overall sales of the company amounted to Rs. 18.5b vis-à-vis Rs. 19.1b during 9M2018. To mitigate the declining demand from the local market in the coming year, IIL plans to develop its export market by exploring in countries such as Thailand, Switzerland and Qatar.

***Steel Pipes Segment***

Given higher demand for steel in the outgoing year, total revenue from the steel segment increased from Rs. 15.5b in FY17 to Rs. 22.8b in FY18. Sales from the steel segment largely comprise Galvanized (GI) and Cold Rolled Coils (CRC) pipes, which are used in utilities and automotive sectors. A smaller portion of the segment is represented by American Petroleum Institute (API) standard pipes. During 2018, the company also amalgamated its stainless steel subsidiary into its steel segment. Going forward, IIL is targeting to increase its market share in automobile sector. Efforts are also being concentrated towards expanding its international clientele to leverage on available capacities and have a natural hedge for foreign exchange risk on its imports.

***Polymer Pipes & Fittings Segment***

Sales of the segment increased from Rs. 1.2b in FY17 to Rs. 2.2b in FY18. However, this segment has a significantly lower contribution to the top line of IIL in comparison to steel. During FY18, polymer segment has witnessed a significant volumetric growth (FY18: 11,084 MT, FY17: 7,169 MT) and increase in prices. Sales growth has been largely contributed by SNGPL gas orders in wake of election year. IIL recently launched PPRC pipes & fittings being used for residential hot and cold water transmission which have also started to contribute in revenues. The company is making efforts to grow demand in the southern region by replacing Polyvinyl Chloride (PVC) pipes with PPRC pipes & fittings. Going forward, overall trend in polymer segment is expected to be stable.

**Profitability**

The Cost of sales of the company increased by 57% as compared to increase of 50% in revenue base mainly due to PKR depreciation. As a result, margins have remained under pressure with gross margin reported lower at 13% (FY17: 18%) in FY18. Gross margin further declined to 10% in 9M2019. The Operating expense base has also expanded due to selling and distribution costs which have increased in line with the growth in sales for FY18. With higher short term borrowings utilized during FY18, the company also incurred a higher markup expense of Rs. 441.7m (FY17: Rs. 224.1m) in FY18.. The company also receives dividend from its subsidiary, International Steel Limited (ISL) which represents a significant contribution in the bottom line of IIL. However, in FY18, ISL announced a lower dividend of Rs. 612.7m for FY18 vis-à-vis Rs. 918.9m last year. However, profit after tax, excluding dividend income, reported at a higher level in comparison to the previous year. With lower margins and dividends coupled with higher expenses, bottom line of the company declined to Rs. 1.6b (FY17: 1.8b) for FY18. During 9M2019, net profit of the company amounted to Rs. 1.36b (9M2018: Rs. 1.39b) with dividend income amounting to Rs. 1.1b. Future profitability of IIL is expected to remain under pressure owing to rising financing costs and nominal revenue growth due to challenging economic conditions and antidumping duty imposed by Canada.

**Liquidity**

Liquidity profile draws support from cash flows generated from operations in relation to outstanding obligations. However, inventory levels have witnessed a noticeable increase on account of management's procurement strategy for tenders in order to avoid risk of price fluctuation. In order to manage its working capital cycle, IIL is focusing to optimize its inventory days on hand. This is expected to reduce holding costs associated with inventory in times of economic slowdown. Working capital management is expected to support its cash flows, going forward. With subdued growth in sales and lower margins, Fund Flow from Operations (FFO) was reported lower at Rs. 1.4b (FY18: Rs. 2.1b, FY17: R-s. 2.6b) for 9MFY19. This translated into a FFO to total debt level of 0.11x (FY18: 0.2x) in 9M2019.

**Funding and Capitalization**

Equity base of the company has increased on a timeline basis on account of consistent profit retention and was reported at Rs 7.3b (FY18: Rs. 6.9b, FY17: Rs. 5.8b) at end-9MFY19. Debt profile of the company mainly comprises of short term borrowings followed by long term facilities. Short term debt was reported higher at Rs. 10.8b (FY18: Rs. 8.3b, FY17: Rs. 5.8b) in order to fund the increase in inventory levels while long term debt amounted to Rs. 2.0b (FY18: Rs. 2.1b, FY17: Rs. 1.3b) at end-9MFY19. Resultantly, leverage indicators have trended upwards. Gearing and leverage stood at 1.77x (FY18: 1.51x, FY17: 1.23x, FY16: 0.85x) and 2.28x (FY18: 1.96x, FY17: 1.82x, FY16: 1.28x), respectively at end-9MFY19. Increase in margins along with improving leverage indicators would be an important rating driver. Going forward, gearing levels will depend on inventory management and capital structure mix with regards to expansion plans of the company.

**Corporate Governance**

Overall corporate governance framework is supported by adequate board composition and oversight as determined by code of corporate governance. Moreover, professional and experienced management team along with strong internal control framework remains the key to efficient management of the overall business structure.

## International Industries Limited Appendix I

| FINANCIAL SUMMARY | | | | (amounts in Rs . millions) |
|---|---|---|---|---|
| **BALANCE SHEET** | **FY16** | **FY17** | **FY18** | **9M2019** |
| Plant, Property and Equipment | 4,852.3 | 5,088.1 | 5,769.7 | 6,531.1 |
| Long term investments | 2,742.7 | 2,742.7 | 3,277.3 | 3,277.3 |
| Stock-in-Trade | 4,058.1 | 8164.9 | 9004.6 | 10,810.2 |
| Trade Debts | 1,624.6 | 1,981.7 | 2,318.9 | 3,733.7 |
| Sales Tax Receivable | 0.0 | 266.8 | 518.4 | 440.2 |
| Cash & Bank Balances | 15.8 | 7.3 | 261.9 | 161.7 |
| Other Assets | 683.2 | 264.9 | 1,314.4 | 772.3 |
| Total Assets | 13,976.7 | 18,516.3 | 22,465.1 | 25,726.6 |
| Trade and Other Payables | 1,858.9 | 2,995.8 | 2,353.7 | 2,229.0 |
| Long Term Debt | 1,196.3 | 1,288.1 | 2,149.5 | 2,080.4 |
| Short Term Debt | 3,243.2 | 5,899.4 | 8,309.6 | 10,779.7 |
| Other Liabilities | 371.8 | 474.2 | 758.0 | 1,445.5 |
| Total Liabilities | 6,670.2 | 10,657.5 | 13,570.7 | 16,534.8 |
| Tier 1 Equity | 5,202.5 | 5,841.4 | 6,936.2 | 7,262.5 |
| Net Worth | 7,306.5 | 7,858.8 | 8,894.4 | 9,191.7 |
| **INCOME STATEMENT** | | | | |
| Net Sales | 14,820.5 | 16,707.0 | 25,001.3 | 18,482.3 |
| Gross Profit | 2,469.1 | 2,840.4 | 3,304.9 | 1,910.4 |
| Selling & Distribution | 783.0 | 873.3 | 1,126.5 | 697.2 |
| Finance Cost | 334.5 | 224.1 | 441.7 | 682.8 |
| Profit After Tax | 786.0 | 1,842.4 | 1,581.7 | 1,357.7 |
| FFO | 1,235.9 | 2,640.7 | 2,116.3 | 1,415.0 |
| **RATIO ANALYSIS** | | | | |
| Gross Margin (%) | 16.7% | 17.5% | 13.2% | 10.3% |
| Net Margin (%) | 5.0% | 11.0% | 6.3% | 7.3% |
| FFO to Long Term Debt (x) | 1.0 | 2.1 | 1.0 | 0.9 |
| FFO to Total Debt (x)* | 0.3 | 0.4 | 0.2 | 0.1 |
| Gearing ratio (x) | 0.9 | 1.2 | 1.5 | 1.8 |
| Leverage ratio (x) | 1.3 | 1.8 | 2.0 | 2.3 |
| DSCR (x)* | 3.2 | 7.9 | 4.7 | 2.8 |
| ROAA (%) | 6.0% | 11.0% | 8.0% | 7.5% |
| ROAE (%) | 16.0% | 33.0% | 25.0% | 25.5% |

**FFO is adjusted and includes dividend income from subsidiary-ISL*

# ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

## RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

**Medium to Long-Term**

**AAA**
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

**AA+, AA, AA-**
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

**A+, A, A-**
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

**BBB+, BBB, BBB-**
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

**BB+, BB, BB-**
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

**B+, B, B-**
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

**CCC**
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

**CC**
A high default risk

**C**
A very high default risk

**D**
Defaulted obligations

**Short-Term**

**A-1+**
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

**A-1**
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

**A-2**
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

**A-3**
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

**B**
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

**C**
Capacity for timely payment of obligations is doubtful.

**Rating Watch:** VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

**Rating Outlooks:** The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

**(SO) Rating:** A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

**(blr) Rating:** A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

**'p' Rating:** A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

**'SD' Rating:** An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

| REGULATORY DISCLOSURES | Appendix III |
|---|---|
| **Name of Rated Entity** | International Industries Limited |
| **Sector** | Steel Industry |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Rating |
| **Rating History** | see table below |
| **Instrument Structure** | N/A |
| **Statement by the Rating Team** | VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities. |
| **Probability of Default** | VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default. |
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**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| | | **RATING TYPE: ENTITY** | | |
| **21-Jun-19** | AA- | A-1 | Stable | Reaffirmed |
| **10-Apr-18** | AA- | A-1 | Stable | Reaffirmed |
| **13-Jan-17** | AA- | A-1 | Stable | Initial |