RATING REPORT

International Industries Limited (IIL)

REPORT DATE:
October 20, 2020

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**AA-/A-1**	**AA-/A-1**
Rating Date	*October 20, 2020*	*June 21, 2019*
Rating Outlook	Rating Watch-Negative	Stable
Outlook Date	*October 20, 2020*	*June 21, 2019*

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' or 'the company') is primarily engaged in the manufacturing of steel and polymer pipes and fittings with an annual manufacturing capacity of 741,200MT. The company has a dominant market positioning in Pakistan with a nation-wide clientele. Sales are led by the North region consisting of Punjab, Khyber Pakhtunkhwa, Azad Jammu and Kashmir and Gilgit-Baltistan followed by the South region consisting of Sindh and Balochistan. IIL is also Pakistan's main exporter of pipes and tubes with a significant export footprint spanning 60 countries across 6 continents with over 850,000 tons of pipe exported to date. As of 2019, export sales contributed 14% of the gross sales of the company.

Steel Sector Update

Table 1: Large-scale Manufacturing – Iron & Steel Subset

	FY19	FY20
Iron & Steel Products	**-11.21%**	**-17.36%**
- Billets/Ingots	-25.30%	-18.33%
- H/C.R.Sheets/Strips/Coils/plates etc	3.00%	-16.64%

- During FY20, Global steel output was lower by 2%; China effectively increased its market share from 53% to 56%, during the period.

- Demand-weakening has been noted across all major economies, with both US & EU, i.e. major demand drivers, both undergoing a pandemic-induced recession

- Given a slowdown in demand, profit margins for steel producers, globally, have come under severe pressure.

- In Pakistan, the pandemic has further exacerbated the issues of the industry, which was already undergoing a downswing induced by the macroeconomic adjustments undertaken by the Government of Pakistan.

- This downswing was reflected in the drop in Large-scale Manufacturing (LSM) index, as illustrated in table 1 above. Improvement has been noted in July'20, with the LSM picking up by 5% vis-à-vis SPLY.

- In the Budget 2020-21, the GoP has further announced a reduction in holding period and tax rates for capital gain on real estate, which should be an added impetus for the construction sector.

- On the other the hand, regulatory duty on Hot Rolled Coils (HRC) of iron and steel has reduced from 12.5% & 17.5% to 6% and 11% respectively, which should benefit pipe manufacturers. Given that flat steel players already enjoy a concessionary regulatory duty of 5%, the development is considered to be a non-event for them.

- Going forward, the demand uptick noted in first 2 months of FY21, is likely to gradually increase. Certain government spending driven demand impetus will be derived from the budgetary allocations under PDSP (Rs. 1.32tr (18% lower than last year)), Dasu and Diamer-Bhasha dam construction (Rs. 69b) and construction of CPEC western route (Rs. 118b) & ML-1 project (Rs. 24b).

<u>Business Update:</u>

IIL's business volumes have been notably impacted in FY20, resulting in a loss for the company, which is a first in 30 years.

- In line with the macroeconomic contraction, the company's business volumes fell notably in FY20.
- As illustrated in table 2, capacity utilization for all segments depicted a negative trend.
- In absolute terms, the topline contracted by 27%.
- In addition the gross margin also fell notably from 10.9% to 7.2%. This was attributable to demand-side weakening caused by the pandemic.
- The drop in margin was more significant for the steel segment, wherein gross margin reduced from 11.1% to 6.2%.
- The cost of debt for the year was also notably higher, given higher average benchmark rates during the year. Based on a two-point average, the cost of debt was roughly higher by 2.5%.
- Given lower business volumes, lower gross margin and higher cost of debt, the company posted a loss of Rs. 694m in FY20, vis-à-vis Rs. 1,575m in the preceding year.
- As per management, business volumes have posted recovery in 2M'FY20, and unless a second wave of Covid-19 does not manifest, the IIL's should be able to recoup the business volumes of FY19 at least.

Table 2: Capacity Utilization

Pipes	FY18	FY19	FY20
Steel Pipes			
Production	515,000	585,000	585,000
Utilization	241,268	192,936	116,660
Capacity Utilization	47%	33%	20%
Galvanizing			
Production	150,000	150,000	120,000
Utilization	82,683	75,454	50,167
Capacity Utilization	55%	50%	42%
Cold Rolled Steel Strip			
Production	50,000	50,000	50,000
Utilization	-	-	-
Capacity Utilization	-	-	-
Polymer Pipes			
Capacity			
Production	25,000	30,000	30,000
Utilization	11,089	10,071	10,361
Capacity Utilization	44%	34%	35%
Stainless Steel - Pipes			
Production	1,200	2,400	2,400
Utilization	673	771	981
Capacity Utilization	56%	32%	41%

	FY18	FY19	FY20
Sales (net)	25,923	25,975	18,964
Market-wise Breakup			
- Domestic*	85.4%	85.7%	87.3%
- Export*	14.6%	14.3%	12.7%
Segment-wise Breakup			
- Steel	91.5%	90.8%	86.9%
- Polymer	8.5%	9.2%	13.1%
Profitability			
Gross Profit	3,305	2,826	1,371
Gross Margin	12.7%	10.9%	7.2%
- Steel	13.0%	11.1%	6.2%
- Polymer	9.8%	9.2%	13.9%
* As a percentage of Gross Sales			

Table 3: Sales & Margins

The company's FFO (inclusive of dividend received from subsidiary) turned negative in FY20, affecting cash flow coverage indicators

Table 4: Cash Conversion Cycle

	FY18	FY19	FY20
Cash Conversion Cycle	128	156	215
- Days Inventory Outstanding	139	157	200
- Days Sales Outstanding	30	38	63
- Days Payable Outstanding	41	38	48

- As stock of inventory, trade debts and payable did not contract in line with the business volumes, the cash conversion cycle has elongated, as illustrated in table 4.
- Given adverse operational performance of its subsidiary, International Steel Limited

(ISL), the dividend income received from subsidiary was notably lower (FY20: Rs. 376m; FY19: Rs. 1,133m).
- Inclusive of dividend income received from subsidiary, the company's FFO remained in negative, as illustrated in table 5.
- The cash flow available for debt servicing (FFO, with interest paid added back), amounted to Rs. 937m (FY19: Rs. 2,885m). This translated in a debt service cover of 0.6x.
- The short-term debt outstanding as of Jun'20, was covered by the stock of inventory and trade debts to the tune of 1.3x.

Table 5: Cash Flow Coverage Ratios

	FY18	FY19	FY20
FFO	**2,116**	**2,026**	**(368)**
FFO to Debt	**20.2%**	**17.7%**	**(3.2%)**
FFO to Long-Term Debt	**98.5%**	**101.6%**	**(18.5%)**
Debt	**10,459**	**11,418**	**11,383**
- Long Term	2,149	1,993	1,988
- Short Term	8,310	9,425	9,394
DSCR (x)	**4.7**	**2.8**	**0.6**

On account of losses, some equity erosion has been experienced, resulting in an uptick in gearing.

- The company's equity has been affected by reduced profitability in FY20. As illustrated in table 6, IIL's equity (excluding surplus on revaluation PPE) declined by 12% in FY20.
- As a result gearing and leverage have trended higher.
- The equity stated herein, excludes the surplus on IIL's strategic holding of ISL, wherein they have a surplus of Rs. 10.2b.
- Given the reduced profitability, dividend payout has been adjusted. In FY20, the Board opted for a 10% bonus share issuance, vis-à-vis cash payout of 54% in the preceding year.

Table 6: Capitalization

	Jun'18	Jun'19	Jun'20
Net Equity	**6,936**	**7,498**	**6,573**
- Paid-up Capital	1,199	1,199	1,319
- General Reserve	2,700	2,700	2,700
- Retained Profits	3,037	3,599	2,554
Surplus on Revaluation of PPE	**1,958**	**2,451**	**2,372**
Gearing	**1.5**	**1.5**	**1.7**
Leverage	**2.0**	**2.1**	**2.2**

Key Rating Rationale

…The ratings are supported by IIL's market positioning in the steel pipe industry group's consolidated position in Pakistan's steel industry

The assigned ratings take impetus from the group's strong operational track record. IIL's subsidiary, ISL, is a market leader in the flat steel industry, while IIL itself is also the biggest manufacturer in the steel pipes domain, with much of its competition coming from the informal sector.

…The adverse business volumes are expected to be a short term trend, barring continued pandemic-induced slowdown in FY21

The contraction in business volumes is in line with contraction in international and domestic economy. Unless a second wave of Covid-19 manifests, the business volumes are expected to normalize going forward. As per management, recovery in demand has already been noted in 2M'FY21. As demand improves, sales volume is expected to recover and the RoAE is likely to recover to its long term trend of more than 20%.

…Topline is likely to be recover in the ongoing year, albeit the pressure on margins is expected to persist.

We have noted the drop in cash flow coverage and the uptick in gearing & leverage, which has breached the threshold for the assigned rating. Although, as the economy recovers, the company's topline is likely to recover in the ongoing year. Nevertheless, pressure on margins is expected to persist.

…Reduced topline with lower margins have affected cash flow coverage

The recent drop in margins comes in continuation to a pre-existing trend. Since FY17 the company's margins have dropped from 16.9% to 7.2% presently. As a result, the cash flow coverage ratios, which were already on a downward trend, have been further impacted. Given negative FFO and DSCR of less than 1x, these ratios deviate from the threshold for the assigned rating. On account of the losses incurred in FY20, gearing & leverage also stand higher on a timeline.

… Good 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	**Jun'17**	**Jun'18**	**Jun'19**	**Jun'20**
Plant, Property and Equipment	5,088	5,770	7,360	7,081
Long term investments	2,743	3,277	3,277	3,295
Stock-in-Trade	8,165	9,005	10,858	8,406
Trade Debts	1,982	2,319	2,988	3,559
Sales Tax Receivable	267	518	279	218
Cash & Bank Balances	7	262	251	299
Total Assets	18,516	22,465	25,327	23,140
Trade and Other Payables	2,996	2,073	2,764	1,846
Long Term Debt	1,288	2,149	1,993	1,988
Short Term Debt	5,899	8,310	9,425	9,394
Total Liabilities	10,658	13,571	15,378	14,194
Paid-up Capital	1,199	1,199	1,199	1,319
Tier 1 Equity	5,841	6,936	7,498	6,573
Net Worth	7,859	8,894	9,949	8,946
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**FY20**
Net Sales	16,707	25,923	25,975	18,964
Gross Profit	2,840	3,305	2,826	1,371
Selling & Distribution	873	1,136	1,141	813
Finance Cost	224	442	924	1,238
Profit Before Tax	2,393	2,149	2,093	(430)
Profit After Tax	1,842	1,582	1,575	(694)
FFO	2,641	2,116	2,026	(368)
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**FY20**
Gross Margin (%)	16.9%	12.7%	10.9%	7.2%
Net Margin (%)	11.0%	6.1%	6.1%	(3.7%)
Current Ratio	1.2	1.2	1.1	1.0
(Trade Debt + Inventory)/ ST Borrowings	1.7	1.4	1.5	1.3
FFO to Long Term Debt (x)	2.1	1.0	1.0	(0.2)
FFO to Total Debt (x)*	0.4	0.2	0.2	(0.0)
Gearing ratio (x)	1.2	1.5	1.5	1.7
Leverage ratio (x)	1.8	2.0	2.1	2.2
DSCR (x)*	7.9	4.7	2.8	0.6
ROAA (%)	11.3%	7.7%	6.6%	(2.9%)
ROAE (%)	33.4%	24.8%	21.8%	(9.9%)

**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)

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
20-Oct-20	AA-	A-1	Rating Watch-Negative	Maintained
21-Jun-19	AA-	A-1	Stable	Reaffirmed
10-Apr-18	AA-	A-1	Stable	Reaffirmed
13-Jan-17	AA-	A-1	Stable	Initial

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.
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Due Diligence Meetings Conducted	(see table below)

Name	Designation	Date
Mr. Muhammad Akhtar	CFO	September 25, 2020