# RATING REPORT

# International Industries Limited (IIL)

**REPORT DATE:**
May 11, 2022

**RATING ANALYSTS:**
Asfia Aziz
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| RATING DETAILS | | |
|---|---|---|
| **Rating Category** | **Latest Rating** | **Previous Rating** |
| **Entity** | **AA-/A-1** | **AA-/A-1** |
| ***Rating Date*** | **May 11, 2022** | *March 12, 2021* |
| **Rating Outlook** | *Stable* | Stable |
| ***Outlook Date*** | May 11, 2022 | *March 12, 2021* |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 1948** | **External auditors:** M/s A.F. Ferguson & Co. |
| **Public Listed Company** | **Chairman of the Board:** Mr. Mustapha A. Chinoy |
| | **Chief Executive Officer:** Mr. Sohail R. Bhojani |
| **Key Stakeholders (with stake 5% or more):** | |
| *Directors, Sponsors and Family Member – 39.4%* | |
| *Govt. Financial Institutions & Associates – 8.3%* | |
| *Banks, DFI & NBFI and Insurance Companies – 6.5%* | |
| *Mutual Funds - 6.5%* | |
| *General Public – 28.9%* | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| ***Applicable Rating Criteria: Industrial Corporates (August 2021)*** |
| ***CorporateMethodology202108.pdf (vis.com.pk)*** |

# 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.

As at March 31, 2022, IIL's subsidiaries include International Steels Limited (ISL) (owns 56.33%), IIL Americas Inc. (owns 100%), IIL Australia Pty Limited (owns 100%), and IIL Construction Solutions (Pvt) Limited (owns 100%). Associate company include Pakistan Cables Limited (PCL). IIL holds 17.124% shares of PCL.

## RATING RATIONALE

International Industries Limited (IIL) enjoys its position as a major market player in the steel industry. It is primarily engaged in the manufacturing of steel pipes and tubes, stainless steel tubes, and polymer pipes and fittings with an annual manufacturing capacity of 817,000 MT. IIL's two production facilities are located in Karachi with one located in Sheikhupura. Regional offices of the company spread across the nation with a dealer network of 450 dealers and distributors. Moreover, to cater exports demand, the company also has on-ground footprint in Australia, Canada, Sri Lanka and Afghanistan. In US and Canada, the company has set up two wholly owned subsidiaries- IIL Americas Inc. and IIL Australia Pty Limited. Assigned ratings incorporate dominant market presence in the local market for GI Pipes, CR Tubes, Stainless Steel Tubes & Pipes, Hollow Structural Section and Black & Scaffolding Pipe. 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.

During the outgoing year, IIL added two polymer extruders of PE and PPRC water pipes. Furthermore, the company also commissioned a stainless steel tube mill and polishing machine for square and rectangular tubes and sections. Capacity utilization levels have depicted an increase during FY21 owing to increased demand post relaxation in COVID-19 related lockdowns across the globe and hike in export orders emanating as a result of diversion of South East Asian exports to Europe and Americas. Going forward, the company plans to increase its PPRC product range by adding uPVC pipes and fittings in its portfolio.

| Installed Capacity | FY20 | FY21 |
|---|---|---|
| Steel pipe | 585,000 | 585,000 |
| Galvanizing | 120,000 | 120,000 |
| Cold rolled steel strip | 50,000 | 50,000 |
| Polymer pipes and fittings | 30,000 | 32,000 |
| Stainless steel pipe | 2,400 | 2,600 |
| **Actual Production** | **FY20** | **FY21** |
| Steel pipe | 116,660 | 169,545 |
| Galvanizing | 50,167 | 75,111 |
| Polymer pipes and fittings | 10,361 | 11,787 |
| Stainless steel pipe | 981 | 1,510 |
| **Utilization** | **FY20** | **FY21** |
| Steel pipe | 20% | 29% |
| Galvanizing | 42% | 63% |
| Polymer pipes and fittings | 35% | 37% |
| Stainless steel pipe | 41% | 58% |

**Business Risk**

Steel sector is characterized by moderate to high business risk given the cyclical nature of the industry. During FY21, the industry faced significant volatility in steel prices where Hot Rolled Coil (HRC) prices hovered in the range of $450-1,100 per MT. A sharp price differential between China and other steel producing countries since post lockdown SE Asian and CIS producers diverted their goods at higher prices. Other factors contributing to the price hike include withdrawal of export rebate on alloy steel by the Chinese Government, acceleration in sea-freight due to shortage of vessels, and capacity cuts in China to curb pollution. Demand drivers for growth in the domestic steel sector going forward emanates from the commencement of second phase of CPEC, construction of 1,100 km gas pipeline from Karachi to Kasur (Pakistan Steam Gas Pipeline project with Russia), and multiple high-rise projects in the pipeline. Imminent industry risks include inventory losses arising as a result of exchange rate volatility.

**Growing sales revenue provided by a higher escalation in exports sales; however local sales continue to dominate the sales mix. Going forward, management projects stable demand flow in the steel segment with additional support foreseen from broadened product range in the polymer segment.**

Revenue base of the company increased by 53% to Rs. 28.9b (FY20: Rs. 18.9b) in FY21. Of its total sales, Rs. 25.6b was contributed by the steel segment while the remaining (Rs. 3.4b) emanated from polymer segment. Around four-fifth of the total sales mix is directed towards the local market. Domestic sales surged by 43% in FY21; however exports sales almost doubled with higher orders emanating from Australia, Canada and Sri Lanka post relaxation of COVID related lockdown. Growth in domestic steel sales was led by strong marketing efforts supported by rebound in sales volumes last year with recovery noted in CR tubes used in automotive and general fabrication segments, and broad-based improvement in construction activities. API sales are contingent on tenders by the GoP, which the company foresees to witness an uptick close to the elections. During HY22, sales revenue has followed a similar growth momentum with sales reported at Rs. 18.2b, primarily attributable to higher international steel prices. The company's export order book remains healthy with continuous efforts by the subsidiaries to expand its footprint in Australia and Canada.

***Steel Pipes Segment***

Pakistan's steel tubes & pipes market size is estimated at approximately 700,000 MT out of a total steel products market size of 9-10 million MT. Structure of the domestic steel tubes & pipes market is highly fragmented and comprises a large number of small-to-medium sized manufacturers, spread across the country. Stainless steel tubes & pipes are typically suited for end-uses that require high corrosion and temperature resistance and aesthetic appeal. Pakistan's average stainless steel per capita consumption is approximately 0.5 kg/capita significantly lower than the world average of 5.7 kg/capita, indicating a substantial potential for growth in this segment. Given higher demand for steel in the outgoing year, total revenue from the steel segment increased to Rs. 25.6b (FY20: Rs. 16.5b) contributed by around 30% increase in volumes and 16% increase in prices. 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. 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***

Polymers segment produces pipes and fittings for transmission and distribution of water and gas as well as for use in telecommunication and ducting applications. Sales of the segment has been consistently increasing on a timeline basis to Rs. 3.4b (FY20: Rs. 2.5b) during FY21. However, this segment has a significantly lower contribution to the top line of IIL in comparison to steel. During FY21, polymer segment has witnessed a significant volumetric growth of around 26% and 10% increase in prices. Sales growth in FY21 has been largely contributed by gas tender business, which is further foreseen to grow 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. Sales volumes were lower by 15% in HY22 because of absence of institutional interest in gas distribution segment. Installation of uPVC pipes and fittings is underway with commissioning expected by April'22. Going forward, overall trend in polymer segment is expected to be stable.

**Improvement in profitability profile supported by inventory gains and dividend income from subsidiary**

After consistently declining since FY18, gross margins of the company increased to 13.7% (FY20: 7.2%) in FY21 owing to inventory gains in the last two quarters. Margins declined to 11.6% in HY22 since the market saw some price correction as high international steel prices of $1,100/MT were not sustainable. However, given Russia being the major supplier of iron-ore, steel prices are expected to remain elevated in the near term amidst Russia-Ukraine war. Selling and distribution expenses were heightened in FY21 and HY22 amounting Rs. 1.5b and Rs. 1.1b respectively (FY20: Rs. 813m) majorly on account of higher freight and forwarding charges. The company also recorded WWF and WPPF expenses due to higher profits. Despite elevated debt levels, overall profitability profile of the company was supported by reduced markup expenses due to reduced interest rates, and income from subsidiary to the tune of Rs. 735m (70% of other income) and Rs. 1.8b in FY21 and HY22, respectively. With improving margins and support of dividend income from International Steel Limited (ISL), net profit after tax was reported at Rs. 2.3b and Rs. 1.8b in FY21 and HY22. Earnings of the first half of the ongoing year were majorly supported by income from subsidiary. Going forward, with projected increase in sales revenue and rebounding of average selling prices, growth in profits is expected to remain stable. However, recent increase in interest rates is expected to be a drag on the overall profitability levels, going forward.

**Adequate liquidity profile**

Liquidity profile draws support from cash flows generated from operations in relation to outstanding obligations. However, inventory levels have witnessed a noticeable increase at end-December'21 on account of management's procurement strategy for orders to avoid risk of price fluctuation. Extended cash conversion cycle of around six months necessitates the utilization of short term financing lines. Trade debts have also increased on a timeline basis in absolute terms due to greater credit period for exports sales; however remains manageable in relation to sales revenue. In line with improvement in profitability profile, Fund Flow from Operations (FFO) was reported higher at Rs. 2.3b (FY21: Rs. 2.3b, FY20: Rs. -368m, FY19: Rs. 2b) for HY22. The same translated into FFO to Total debt and FFO to Long Term Debt of 28.2% (FY21: 17.3%) and 152.5% (FY21: 76.7%) for FY21 and HY22, respectively. Meeting projected liquidity indicators is considered important from a ratings perspective.

**Elevated leverage levels to finance working capital requirements. Improvement in the same is considered important**

Equity base of the company (excluding revaluation surplus) has increased on a timeline basis on account of consistent profit retention and was reported at Rs 9.5b (FY21: Rs. 8.4b, FY20: Rs. 6.6b) at end-Dec'21. Debt profile of the company mainly comprises of short term borrowings followed by long term facilities. Short term debt was reported higher at Rs. 13.25b (FY21: Rs. 10.2b, FY20: Rs. 9.4b) at end-Dec'21 in order to fund the increase in inventory levels while long term debt amounted to Rs. 3b (FY21: Rs. 3b, FY20: Rs. 2b). The increase in long-term financing was to fund capital expenditure in the polymer business segment during FY21. Resultantly, leverage indicators have trended upwards. Gearing and leverage stood at 1.72x (FY21: 1.56x, FY20: 1.73x) and 2.26x (FY21: 2.05x, FY20: 2.2x), respectively at end-Dec'21. 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 routine capex plans of the company. Meeting projected lower leverage levels is considered important.

**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.

During the year 2020-21, a casual vacancy arose on the Board of Directors led by the resignation of Mr. Ehsan Ali Malik which was filled by Mr. Asif Jooma as Director for the remaining term of the existing Board of Directors. Mr. Riyaz T. Chinoy, stepped down from the position of CEO at the close of business on February 9, 2021 and his resignation from the Board of Directors was filled by Mr. Haider Rashid for the remaining term.

## International Industries Limited Appendix I

| FINANCIAL SUMMARY (Unconsolidated) | | | | | |
|---|---|---|---|---|---|
| **BALANCE SHEET** | **FY18** | **FY19** | **FY20** | **FY21** | **1HFY22** |
| PPE | 5,770 | 7,360 | 7,081 | 7,480 | 7,693 |
| Long Term Investments | 3,277 | 3,277 | 3,295 | 3,373 | 3,373 |
| Stock-in-Trade | 9,005 | 10,858 | 8,406 | 11,924 | 13,362 |
| Trade Debts | 2,319 | 2,988 | 3,559 | 5,138 | 8,412 |
| Cash & Bank Balances | 262 | 251 | 299 | 73 | 103 |
| Total Assets | 22,465 | 25,327 | 23,140 | 28,791 | 33,869 |
| Trade and Other Payables | 2,073 | 2,764 | 1,846 | 3,097 | 3,627 |
| Short Term Borrowings | 8,310 | 9,425 | 9,394 | 10,181 | 13,250 |
| Long Term Borrowings inc. Current Maturity | 2,149 | 1,993 | 1,988 | 2,961 | 3,006 |
| Total Interest Bearing Debt | 10,459 | 11,418 | 11,383 | 13,143 | 16,256 |
| Total Liabilities | 13,571 | 15,378 | 14,194 | 17,293 | 21,358 |
| Paid-up Capital | 1,199 | 1,199 | 1,319 | 1,319 | 1,319 |
| Total Equity (Excluding Revaluation Surplus) | 6,936 | 7,498 | 6,573 | 8,438 | 9,464 |
| **INCOME STATEMENT** | | | | | |
| Net Sales | 25,923 | 25,975 | 18,964 | 28,940 | 18,225 |
| Cost of Sales | (22,619) | (23,149) | (17,593) | (24,967) | (16,120) |
| Gross Profit | 3,305 | 2,826 | 1,371 | 3,973 | 2,106 |
| Other income | 883 | 1,733 | 580 | 1,054 | 2,059 |
| Finance Cost | (442) | (924) | (1,238) | (756) | (472) |
| Profit before Tax | 2,149 | 2,093 | (430) | 2,259 | 2,345 |
| Profit After Tax | 1,582 | 1,575 | (694) | 2,315 | 1,857 |
| **RATIO ANALYSIS** | | | | | |
| Gross Margin | 12.7% | 10.9% | 7.2% | 13.7% | 11.6% |
| Net Margin | 6.1% | 6.1% | -3.7% | 8.0% | 10.2% |
| Current Ratio (x) | 1.19 | 1.11 | 1.04 | 1.19 | 1.18 |
| Gearing (x) | 1.51 | 1.52 | 1.73 | 1.56 | 1.72 |
| Debt Leverage (x) | 1.96 | 2.05 | 2.16 | 2.05 | 2.26 |
| FFO | 2,116 | 2,026 | (368) | 2,271 | 2,293 |
| FFO to Long Term Debt (%) | 98.5% | 101.6% | -18.5% | 76.7% | 152.5% |
| FFO to Total Debt (%) | 20.2% | 17.7% | -3.2% | 17.3% | 28.2% |
| Debt Servicing Coverage Ratio (x) | 4.75 | 2.77 | 0.59 | 2.62 | 3.31 |
| ROAA (%) | 8.0% | 6.6% | -2.9% | 8.9% | 11.9% |
| ROAE (%) | 25.0% | 21.8% | -9.9% | 30.8% | 41.5% |
| DSO | 30 | 37 | 63 | 55 | 68 |
| DPO | 41 | 38 | 48 | 36 | 38 |
| DIO | 139 | 157 | 200 | 149 | 143 |
| CCC | 128 | 156 | 215 | 167 | 173 |

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

# 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.

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**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** | |

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| **11-May-22** | AA- | A-1 | Stable | Reaffirmed |
| **12-Mar-21** | AA- | A-1 | Stable | Maintained |
| **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. |
| **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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| **Due Diligence Meetings Conducted** | Mr. Muhammad Akhtar- Chief Financial Officer- April 01, 2022<br>Mr. Salman Najeeb- Financial Controller- April 01, 2022 |