RATING REPORT

International Industries Limited (IIL)

REPORT DATE:
April 7, 2023

RATING ANALYSTS:
Asfia Aziz
asfia.aziz@vis.com.pk

Basel Ali Assad
basel.ali@vis.com.pk

RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	**AA-/A-1**	**AA-/A-1**
Rating Date	**April 7, 2023**	**May 11, 2022**
Rating Outlook	*Rating Watch-Developing*	*Stable*
Outlook Date	April 7, 2023	May 11, 2022
Rating Action	Maintained	Reaffirmed

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 Members – 40.9%	
General Public – 29.0%	
Govt. Financial Institutions & Associates – 11.2%	
Public, Private and Other Companies – 9.6%	
Banks, DFI & NBFI and Insurance Companies – 6.2%	

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

International Industries Limited (IIL)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 of June 30, 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) (owns 17.12% of PCL shares).

Corporate Profile

International Industries Limited (IIL) is one of the prominent market players in the production of steel pipes and tubes, stainless steel tubes and polymer pipes and fittings. The company has two manufacturing facilities located in Karachi and Sheikhupura with a total production capacity of about 817,000MT. The company has significant international presence and export demand, particularly in Australia, Canada and Sri Lanka, through two of its wholly-owned subsidiaries, IIL Americas Inc. and IIL Australia Pty. Inc, which are set up in Canada and Australia, respectively. In addition, a new wholly-owned subsidiary, IIL Construction Solutions (Pvt.) Ltd. was set up in the previous year to provide the local market with innovative engineering services. This subsidiary initiated a partnership with MEVA Schalungs Systeme, a world leading engineering company in FY22, to utilize their technology and expertise particularly pertaining to shuttering activities in the construction process. As per management, projects envisaged for IIL Construction Solutions will be undertaken from IIL's books given easier accessibility of finance.

IIL has an in-house power generation capacity of 4MW which is sufficient to meet the requirements of the company and any excess production is supplied to the national grid. The company has also installed a 2MW solar power facility across two of its manufacturing units and has plans to further enhance capacity of 1MW in the third unit over the rating horizon to help reduce energy costs.

Heightened Business Risk

The steel industry is prone to fluctuations and has a moderate to high level of risk. Raw material prices were unstable due to increased demand after COVID-19 and limited supply, along with tensions in the Russia-Ukraine conflict that further affected global supply chains. In particular, the price of hot-rolled coils (HRC) reached an all-time high of $2,100/MT in September 2021, but has since declined to about $508/MT in December 2022. The decrease was due to reduced demand caused by China's zero-COVID policy, a downturn in the real estate construction industry, and global restrictive monetary policies. Additionally, the energy crisis in Europe resulting from the Russia-Ukraine conflict negatively impacted industrial activities. Spot prices of SS400 grade hot-rolled coil remained within $600-$670/MT FOB China levels between January and February'23.

In Pakistan, the steel and pipes industry makes up about 750,000 MT of the total steel market size of approximately 9-10m MT. This industry comprises mainly of small-medium sized firms and is highly fragmented. The average consumption of steel per capita in the country is only 46kg, which is significantly lower than the global average of 233kg suggesting considerable growth opportunity. However, there are significant challenges that elevate business risk in the steel sector. The government's restrictions on obtaining Letters of Credit (LC) for imports due to a lack of foreign exchange reserves have made it difficult to procure key imported raw materials needed for production. Moreover, ongoing currency devaluation, high policy rates, and rising fuel and electricity costs have increased manufacturing costs. The steel industry is also closely linked to the domestic flat steel sector, which contracted by 14% in the outgoing year.

Furthermore, the overall demand was also impacted by the worsening macroeconomic situation and restrictive government policies, as reflected by the 3.58% decline in the large-scale manufacturing index during July-Nov'22 compared to the same period last year. Although IIL did not face any problems in opening LCs due to available export proceeds, the quantum of raw material imports plunged in the current year due to subdued business activity and low sales volumes.

Capacity and Operations

During the outgoing year, IIL enhanced its production capacity in both its steel and polymer segments. Four stainless steel tube mills and polishing machines for square and rectangular tubes and sections have been installed as well as two additional polymer extruders for PE and PPRC water pipes. In addition, the company completed the construction of a new uPVC pipes and fittings plant at a cost of Rs. 200m to enhance its polymer product portfolio. Overall, decrease in demand owing to lower economic activity, inflationary pressures and rise in policy rates resulted in lower capacity utilization for most segments. However, utilization levels for the galvanizing steel segment increased due to reduction in production capacity on account of closure of one of the three plants. The remaining two plants were operating on a 3-shift per day basis instead of a 2-shift basis. Additionally, the company's stainless steel pipe product line witnessed an uptick in volumetric output owing to the introduction of a new economical series of pipes. With subdued market sentiments, overall utilization levels in the short-term are expected to remain bleak. Breakdown of capacity utilization can be seen below:

Available Production Capacity (MT)		
	FY21	**FY22**
Steel Pipe	585,000	585,000
Galvanizing	120,000	90,000
Cold Rolled Steel Strip	50,000	50,000
Polymer Pipes and Fittings	32,000	35,000
Stainless Steel - Pipes	2,600	4,800
Actual Production (MT)		
	FY21	**FY22**
Steel Pipe	169,545	144,539
Galvanizing	75,111	64,320
Polymer Pipes and Fittings	11,787	7,582
Stainless Steel - Pipes	1,510	1,867
Capacity Utilization (%)		
	FY21	**FY22**
Steel Pipe	29.0%	24.7%
Galvanizing	62.6%	71.5%
Polymer Pipes and Fittings	36.8%	21.7%
Stainless Steel - Pipes	58.1%	38.9%

Topline growth in FY22 supported by elevated prices; however the same showcased weakening in the ongoing year due to subdued demand from both local and export markets. Net margins continues to get support from subsidiary's dividend income. Projected absence of the same in the near term may create pressure on net margins.

The company registered a notable 30.8% growth in net sales during FY22 amounting to Rs. 37.9b in the outgoing year (FY21: Rs. 28.9b) contributed by a 45% hike in average selling prices. However, volumes decreased by 10% YoY due to a slowdown in large-scale manufacturing caused by import restrictions, currency depreciation, and high policy rates affecting industrial activity in the local market. Domestic sales comprised 71% of total sales, with the remaining being export sales. Significant surge in export sales from Rs. 5.9b in FY21 to Rs. 11.1b in FY22 was attributable largely to higher average selling prices (yield from dollar appreciation) and to a 9% volumetric growth emanating from higher demand from Canada and Australia which offset the decrease in export orders from Sri Lanka owing to the deteriorating economic and political situation there. The steel division contributed about 93% of total net sales, with cold-rolled coil (CRC) pipes and galvanized iron (GI) pipes being the primary drivers. Polymer capacity increased, but sales decreased to Rs. 2.7b (FY21: Rs. 3.4b) in FY22 due to a lack of government tender orders.

In the first half of FY23, the company's sales turnover decreased by 28.7% YoY to Rs. 13b due to deteriorating macroeconomic indicators, resulting in a significant drop in demand for steel products. Export orders also declined by about 47.7% on an annualized basis compared to FY22 due to global monetary tightening and rising inflation. The polymer segment saw some growth in revenue, largely due to price benefits and a few large orders from institutional customers.

Gross margins decreased to 12.3% in FY22 (FY21: 13.7%) primarily on the account of higher cost of sales which stood at Rs. 33.2b (FY21: Rs. 25b). Raw materials contributed significantly to this increase, comprising about 92.7% of cost of goods manufactured (FY21: 90.6%) with the international prices of hot-rolled coil (HRC) and zinc, two key imported components of steel production, reaching unprecedented heights as the Russia-Ukraine war exacerbated supply side issues globally during FY22. While import restrictions have lowered the quantum procured for HRC and zinc, cold rolled coils (CRC), another vital raw material, is largely being purchased locally owing to ample supply in the market, according to management. Despite support of sizeable dividend income from subsidiary amounting Rs. 3.3b (FY21: Rs.1.1b) in FY22, net margins reduced to 5.7% (FY21: 8%). Factors causing the same include rise in selling and distribution expense, higher financing costs amounting to Rs. 1.2b (FY21: Rs. 755.8m) and greater tax burden due to the imposition of super tax as well as large deferred tax credits providing overall tax benefit in the previous year.

During 1HFY23, gross margins continued its downward trend, standing at 10.9%, owing to higher raw material costs despite international prices for raw materials witnessing a decline as significant rupee devaluation offset any possible benefits in the ongoing year. Additionally, import restrictions and lower demand have resulted in the management resorting to procurement of lower volumes of raw materials to maintain margin levels. Net margins, on the other hand, remained stable at around 5.9% supported by dividend income from subsidiary and lower operating expenses on an annualized basis. Given subdued outlook for the overall steel sector, limited demand for pipes and projected absence of sizeable dividend income from subsidiary, VIS projects stress on the profitability profile of the company with high interest cost causing an additional drag.

Stressed liquidity profile in HYFY23 provided by lower production & margins and higher finance charges.

Although the liquidity profile of the company was adequate until FY22, the funds from operations (FFO) for HYFY23, which includes support from dividend income, decreased significantly to Rs. 999m (FY22: Rs. 3.8b, FY21: Rs. 2.8b) due to depressed production volumes, stressed gross margins, and elevated financial costs. As a result, FFO to total debt, FFO to long-term debt, and debt service coverage ratio decreased to 16.3% (FY22: 24.9%, FY21: 17.3%), 39.9% (FY22: 154.7%, FY21: 76.7%), and 1.3x (FY22: 2.62x, FY21: 2.6x), respectively. Improvement in liquidity indicators will be crucial from a ratings perspective.

The stock-in-trade amounted to Rs. 10.9b (FY22: Rs. 13.6b, FY21: Rs. 11.9b) at end-Dec'22 and can cover about three months of raw material requirements. Trade debts were reported at Rs. 6.9b (FY22: Rs. 8.8b, FY21: Rs. 5.1b) at end-Dec'22 and remained manageable relative to net sales, accounting for about 26.6% of the topline (FY22: 23.2%, FY21: 17.8%) in HYFY23. At the end of June 2022, most of the trade receivables were due from the company's wholly owned subsidiaries, IIL Australia Pty. (Ltd.) and IIL Americas Inc., cumulatively comprising about 60% of the total trade debts due. The current ratio increased to 1.43x (FY22: 1.16x, FY21: 1.19x) mainly due to the conversion of short-term debt to long-term debt, resulting in lower short-term borrowings. However, the net operating cycle increased to about eight months, which is higher relative to the industry, due to lower sales and inventory turnover. Ratings remain underpinned on improvement in liquidity indicators being in line with benchmarks for the assigned ratings.

Capitalization profile improved in view of debt re-profiling during the ongoing year.

Growth in IIL's equity base has remained subdued in the review period due to lower profits in HYFY23 and consistent dividend payout. Total borrowings, comprising mostly of short-term debt, witnessed a decrease to Rs. 12.2b (FY22: Rs. 15.1b, FY21: Rs. 13.1b) at end-Dec'22. This is attributable to a notable reduction in short-term borrowings to Rs. 7.2b (FY22: Rs. 12.6b, FY21: Rs. 10.2b) at end-Dec'22 due to re-profiling of its debt structure by converting short-term debt to long-term debt and due to lower stock-financing. This re-profiling resulted in higher long-term borrowings to the tune of Rs. 5b (FY22: Rs. 2.4b, FY21: Rs. 3b) at end-Dec'22. Resultantly, gearing and leverage indicators improved to 1.29x (FY22: 1.59x, FY21: 1.56x) and 1.88x (FY22: 2.29x, FY21: 2.05x) respectively at end-Dec'22. Going forward, leverage indicators will be sensitive to the company's internal capital generation ability, working capital strategy and any further capital expenditures requirement for IIL Construction Solutions Projects.

Corporate Framework

The company has a satisfactory corporate governance framework with adequate board composition, presence of board committees and female representation, in line with best practices. In addition, the experience and expertise of the senior management as well as strong internal controls provides strength to the overall corporate framework from a ratings perspective.

During the outgoing year, the board composition witnessed a change with a casual vacancy arising from resignation of Mr. Riyaz T. Chinoy, a non-executive director, who was replaced with Mr. Haider Rashid for the remaining term.

International Industries Limited Appendix I

FINANCIAL SUMMARY (Unconsolidated)				*(amounts In PKR millions)*
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**1HFY23**
PPE	7,081	7,480	9,984	9,990
Long Term Investments	3,295	3,373	3,373	3,373
Stock-in-Trade	8,406	11,924	13,578	10,925
Trade Debts	3,559	5,138	8,800	6,922
Cash & Bank Balances	299	73	114	140
Total Assets	23,140	28,791	36,296	32,464
Trade and Other Payables	1,846	3,097	4,440	3,296
Short Term Borrowings	9,394	10,181	12,637	7,249
Long Term Borrowings Incl. Current Maturity	1,988	2,961	2,425	5,005
Total Interest-Bearing Debt	11,383	13,143	15,063	12,254
Total Liabilities	14,194	17,293	21,701	17,925
Paid-up Capital	1,319	1,319	1,319	1,319
Total Equity (Excluding Revaluation Surplus)	6,573	8,438	9,484	9,518
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**1HFY23**
Net Sales	18,964	28,940	37,858	12,989
Cost of Sales	(17,593)	(24,967)	(33,189)	(11,568)
Gross Profit	1,371	3,973	4,669	1,421
Other income	580	1,054	3,261	1,531
Finance Cost	(1,238)	(756)	(1,182)	(929)
Profit before Tax	(430)	2,259	3,657	1,083
Profit After Tax	(694)	2,315	2,156	764
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**1HFY23**
Gross Margin	7.2%	13.7%	12.3%	10.9%
Net Margin	-3.7%	8.0%	5.7%	5.9%
Current Ratio (x)	1.04	1.19	1.16	1.43
Gearing (x)	1.73	1.56	1.59	1.29
Debt Leverage (x)	2.16	2.05	2.29	1.88
FFO (Including dividend from ISL)	(368)	2,271	3,752	999
FFO to Long Term Debt (%)	-18.5%	76.7%	154.7%	39.9%*
FFO to Total Debt (%)	-3.2%	17.3%	24.9%	16.3%*
Debt Servicing Coverage Ratio (x)	0.59	2.62	2.60	1.30*
ROAA (%)	-3.0%	8.9%	6.6%	4.4%*
ROAE (%)	-10.6%	30.8%	24.1%	16.1%*
DSO	63	55	67	110
DPO	48	36	41	61
DIO	200	149	140	193
CCC	215	167	166	243
Trade Debts/Sales	18.8%	17.8%	23.2%	26.6%*

* *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.

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				
7-Apr-23	AA-	A-1	Rating Watch-Developing	Maintained
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

	Name	Designation	Date
1	Mr. Muhammad Akhtar	CFO	02/20/2023