RATING REPORT

Agro Steel Industry (ASI)

REPORT DATE:
April 09, 2020

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	BBB-	A-2
Rating Date	*April 09, 2020*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 1995	**External auditors:** Azam&Co. Chartered Accountants
Partnership	**ManagingPartner:** Mr. Khurram Iqbal
Key Shareholders: (Above 5%)	
Mr. Muhammad Iqbal 30%	
Mr. Khurram Iqbal 20%	
Mr. Tariq Mahmood 30%	
Mr. Junaid Tariq 20%	

APPLICABLE METHODOLOGY

VIS Entity Rating Criteria: Corporates (May 2019)
https://www.vis.com.pk/kc-meth.aspx

OVERVIEW OF THE INSTITUTION

Agro Steel Industry was incorporated in 1995 as an association of persons under the Partnership Act, 1932. The firm is principally engaged in manufacturing and sale of steel products.

Profile of Managing Partner

Mr. Khurram is an MBA in finance & banking. He has been associated with Agro Steel Industries for around 11 years in the capacity of managing partner.

Financial Snapshot

Core Equity: end-FY19: Rs. 296.7m; end-FY18: Rs. 286.9m; FY17: Rs. 275.1m

Assets: end-FY19: Rs. 387.3m; end-FY18: Rs. 401.3m; FY17: Rs. 434.3m

Profit After Tax: FY19: Rs. 28.3m; FY18: 27.9m; FY17: 23.1m

RATING RATIONALE

Agro Steel Industry (ASI) is a small-sized manufacturing and trading concern; managed and owned by family members. The ratings assigned take into account sustained profitability, supported by a steady demand of high carbon steel products in the local market. Sustained margins, adequate liquidity and low leverage indicators provide support to the financial profile and are among the key ratings drivers. However, the ratings are constrained by limited scale of operations, presence of the firm in a sector characterized by steady, though limited demand, and small equity base. Furthermore, partnership structure implies additional element of volatility in the capital structure. The ratings also incorporate possible impact of currency fluctuation on the prices of imported raw material and any adverse changes in regulatory duties.

Key Rating Drivers:

Firm's profile: ASI was incepted in early 1980s by Mr. Muhammad Iqbal, having more than thirty years of experience of steel business. Mr. Iqbal and his son, Mr. Khurram Iqbal along with Mr. Tariq Mahmood (brother of Mr. Iqbal) and his son, Mr. Junaid Tariq, have been actively involved in the management of the firm. The firm specializes in high carbon steel including flat bars, round bars and agricultural products.

High carbon steel industry is characterized by limited market demand of ~6000 M.T per month, met by a blend of regulated and non-regulated players. The players are concentrated in the Punjab region. As per management, direct competitors of the company for high carbon steel products include, Inam Steel Re-Rolling Mills, Anas Steel Re-Rolling Mills, Pak Steel Re Rolling Mills & Agricultural Implements and a few other non-regulated players. Monthly production capacity of rolling mill of ASI is around 1,500 M.T for a wide-range of flat bars and round bars. Capacity utilization has remained around 80% in conformance with market demand. The leaf spring manufacturing plant of the firm is fully equipped with modern manufacturing and testing facilities to manufacture leaf springs. Presently the manufacturing facilities include automated camber press & quenching machine, automated heating furnace and lengthened conveyor type shot peening machine. Testing facilities include fatigue testing machine, computerized presetting and load testing machine.

Asset mix: Long-term assets comprising property, plant and equipment stood lower at Rs. 58.9m (FY18: Rs. 63.3m; FY17: Rs. 68.2m) at end-FY19 due to the impact of depreciation. Stock in trade remained almost at prior year's level of Rs. 101.1m (FY18: Rs. 97.9m; FY17: Rs. 90.5m) at end-FY19. Raw material is purchased on continuous basis and one-month buffer stock is kept in finished goods. Trade receivables amounted to Rs. 119.0m (FY18: Rs. 116.7m; FY17: Rs. 149.1m) at end-FY19, that fall under 3 months' credit bracket. Around 50% sales is made on cash basis, while a maximum of three months' credit period is provided to customers. As per management, efforts are being made to increase the proportion of sales on cash basis to improve working capital management and reduce finance cost. Advances & deposits stood lower at Rs. 95.0m (FY18: Rs. 110.7m; FY17: Rs. 109.0m) at end-FY19, mainly due to lower advances paid for purchases.

Procurement of raw material: Around 90%of the raw material is imported. Foreign suppliers include, Jarnmalamr AB (Sweden), Midas Global (United Kingdom), Global Metcorp (United Kingdom), Tolmets (Latvia) and Starglobe Limited(Russia). Local materials are procured from an indenting company namely 'Better Deals' and different local suppliers. Regulatory and additional custom duty of 5% and 2% respectively are applicable on all relevant products.

Product mix: Products are broadly divided into two types in terms of their usage; Auto products (Re-Rolling products) include round bars, flat bars and leaf springs, while agricultural products comprise tiller, disc plough, chisel
plough, mounted MB plough, ridger, sub-soiler and mounted tandem disc harrows. Flat bar, having relatively higher gross margin, accounted for 65% of the total revenue, round bar contributed 20% to the total sales, while 10% of the total sales are made to Pakistan Railways and other Government institutions related to specific materials. The firm started manufacturing and selling angle iron to diversify its product mix, which accounted for 5% of the total sales during FY19.Althoughangle iron fetches relatively lower margins, the management intends to increase its sale on the back of positive market response, going forward.

Major customers included automotive parts and agricultural implements providers: As per management, clients vary with time depending on availability, pricing and quality of materials. A list of major clients is presented below:

- Pakistan Spring Industry, Gujranwala
- National Automotive (Pvt.) Limited, Lahore
- Albadar Engineering (Pvt.) Limited, Lahore
- Gaizani Engineering, Karachi
- Popular Spring, Gujranwala
- Rail Corp. Lahore
- Farm Development Industries, Lahore
- Hafeez Agro, Gujranwala

Stable demand and market share in high carbon steel products: The firm's sales witnessed a modest growth with CAGR of 2.7% over the last three years mainly on back of higher product prices. Accordingly, ASI's topline stood higher at Rs. 523m (FY18: Rs. 482.2m; FY17: Rs. 470.9m) during the review period. Cost of raw material consumed accounting for ~88% of the total cost of sales, increased to Rs. 418.4m (FY18: Rs. 389.4m; FY17: Rs. 382.5m) during FY19, on account of higher cost of imported raw material owing to local currency depreciation. Other components of cost of sales also increased due to inflationary pressure. Due to higher product prices and rationalized increase in cost of sales, gross margins increased to 8.8% (FY18: 8.1%; FY17: 7.0%) during FY19.

Administrative expenses remained modest at prior year's level at Rs. 1.9m (FY18: Rs. 1.9m; FY17: Rs. 1.7m) during FY19. Finance cost increased to Rs. 9.5m (FY18: Rs. 3.2m; FY17: Rs. 3.1m) during the same period, due to higher benchmark rates. Accounting for taxation net profits amounted to Rs. 28.3m (FY18: Rs. 27.9m; FY17: 23.1m) during FY19.

Adequate liquidity and debt service ability: FFO stood at Rs. 32.7m (FY18: Rs. 32.8m; FY17: Rs. 28.5m) in FY19. FFO to total debt increased to 0.74x (FY18: 0.32x; FY17: 0.19x) due to lower short-term borrowings by end-FY19. Debt Service Coverage ratio (DSCR), though decreased to 3.43x (FY18: 10.09x; FY17: 9.20x) on account of higher finance cost paid during FY19, is considered adequate.

Current ratio increased to 3.6x (FY18: 3.0x; FY17: 2.3x) by end-FY19, due to lower current liabilities. Trade and other payables, constituting local creditors increased to Rs. 43.3m (FY18: Rs. 8.8m; FY17: 8.5m) at end-FY19.Foreign purchases are made on LC at sight, while a credit period of 40-45days is availed for majority of the local purchases. Cash conversion cycle decreased to 139days (FY18: 171 days; FY17: 180 days) on back of overall improvement in working capital management on a timeline basis. Furthermore, coverage of short-term borrowings via trade debts and inventory stood higher at 5.0x (FY18: 2.1x; FY17: 1.6x) at end-FY19.

Conservative capital structure amid stagnant and small equity base: Equity base remained largely stagnant over the last three years due to limited profitability and drawings by partners. Core equity stood at Rs. 296.7m (FY18: Rs. 286.9m; FY17: Rs. 275.1m) at end-FY19.Capital drawn by partners amounted to Rs. 18.5m (FY18: Rs. 16.0m; FY17: Rs. 15.6m) during FY19; the same averaged at 63% of net profit during the last three years. ASI balance sheet has remained long-term debt free. There was no off-balance sheet funding as on the balance sheet date. Short term borrowings stood lower at Rs. 44.5m (FY18: 103m; FY17: Rs. 148.2m) at end-FY19; management plans to decrease average short-term borrowings to reduce financial cost while funding working capital requirements mainly through internally generated capital. The company has available credit lines worth Rs. 205m from various banks, subject to markup at rate of 3M KIBOR plus 3% per quarter/annum. Debt leverage and gearing decreased to 0.31x and 0.15x (FY18: 0.40x & 0.36x; FY17: 0.58x & 0.54x) respectively by end-FY19. Given no plan to procure further debt, leverage indicators are expected to remain low. As per management, considering economic slowdown and higher interest rates, the firm does not intend to incur any capital expenditure in the foreseeable future.

BALANCE SHEET (PKR millions)	FY17	FY18	FY19
Property, plant & Equipment	68	63	59
Stores, Spares and Loos Tools	3	3	3
Stock-in-Trade	91	98	101
Trade Debts	149	117	119
Advances and Deposits	109	111	95
Cash & Bank Balances	15	10	10
Total Assets	435	402	387
Trade and Other Payables	8	9	43
Long Term Debt *(including current maturity)*	-	-	-
Short Term Debt	148	103	44
Other Liabilities	3	3	3
Total/Tier-1 Equity	275	287	297
Paid-up Capital			
INCOME STATEMENT	**FY17**	**FY18**	**FY19**
Net Sales	471	482	523
Gross Profit	33	39	46
Operating Profit	31	37	44
Profit Before Tax	28	34	35
Profit After Tax	23	28	28
Funds from Operations	29	33	33
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**
Gross Margin (%)	7.0	8.1	8.8
Net Margins (%)	4.9	5.8	5.4
Current Ratio (x)	2.30	2.95	3.63
Net Working Capital	207	224	238
FFO to Total Debt (x)	0.19	0.32	0.74
FFO to Long Term Debt (x)	-	-	-
Debt Leverage (x)	0.58	0.40	0.31
Gearing (x)	0.54	0.36	0.15
DSCR (x)	9.2	10.1	3.4
ROAA (%)	6.0	6.7	7.2
ROAE (%)	8.5	9.9	9.7
Drawings (%)	67.4	57.4	65.4
(Stock in Trade+Trade Debt) to Short-Term Borrowing Ratio (x)	1.6	2.1	5.0

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

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	Agro Steel Industry				
Sector	Steel & Allied Products				
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				
	09/04/20	BBB-	A-2	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. Khurram Iqbal	Managing Partner	02-March-2020	