RATING REPORT

Frontier Foundry Steel (Private) Limited

REPORT DATE:
August 25, 2020

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Date	25th Aug'20		11th *Feb'19*	
Rating Outlook	Positive		Stable	

COMPANY INFORMATION

Incorporated in 1986	External auditors: Rafaqat Babar & Co. Chartered Accountants
Private Limited Company	Chairman: Mr. Nauman Wazir Khattak CEO: Mr. Zarak Khan
Key Shareholders (with stake 5% or more):	
Zarak Khan – 80.2% Nauman Wazir Khattak – 16.5%	

APPLICABLE METHODOLOGY(IES)

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

Frontier Foundry Steel (Private) Limited

OVERVIEW OF THE INSTITUTION

Frontier Foundry Steel (Private) Limited (FFSPL) was incorporated as a Private Limited Company in 1986. The company's core business relates to manufacturing of rebars with the production plants situated in Peshawar and Lahore.

Profile of Chairman
Mr. Nauman Wazir Khattak, a sitting senator, graduated as an Aeronautical Engineer in 1977 and holds directorship in SNGPL, Pakhtunkhwa Energy Development Organization, FATA Development Authority, Engineering Development Board, Water and Sanitation Services Peshawar, City University Peshawar and Sarhad University of Science and Technology, Peshawar.

Profile of CEO
Mr. Zarak Khan has an undergraduate degree in mechanical engineering from Ghulam Ishaq Khan Institute of Engineering Sciences & Technology. He was awarded a gold medal in his bachelor's degree for his academic achievement.

RATING RATIONALE

Frontier Foundry Steel (Private) Limited (FFSPL) deals in manufacturing of billets and reinforcement bars (rebars). The company has a mid-sized installed capacity of rebars with plants present in the cities of Peshawar and Lahore. The assigned ratings take into account largely sustained revenues as its growth momentum was impacted by the outbreak of COVID-19 and pre-pandemic economic slowdown. Ratings also reflect improvement in margins due to partial consumption of in-house produced billets and cost efficiencies.

Liquidity profile of the company is supported by adequate cash flows generation in relation to outstanding financial obligations. Manageable increase in leverage indicators was witnessed on account of higher utilization of debt financing for capex and working capital requirements. Ratings are dependent on maintaining prudent leverage indicators in the backdrop of notable capex being undertaken by FFSPL, improving margins and timely materialization of the expansion project.

Overall sectoral risk is considered moderate-to-high given the fragmented and cyclical nature of the industry, emerging competition post-capacity expansion by major players, and threat of dumping from countries on which duties have not been imposed as well as high reliance on Government protection. After a period of challenging demand dynamics due to slower economic growth and outbreak of COVID-19, FFSPL is expecting higher demand for steel on account of construction industry relief package and further relief measures introduced in the budget 2020-21, and the government's spending on construction of development projects, dams, and housing units.

The installed capacity of rebars is 322,000MT which comprises 72,000MT capacity of Peshawar plant and 250,000MT capacity of Lahore plant. Capacity utilization of the company's rebars unit was recorded at 36% (FY19: 38%) during FY20.

Expansion Plans
Following are the details of expansion plans of the company:

- **Lahore Project Phase I:** This project commenced operations in April'2018 with an installed rebar capacity of 250,000MT per annum. The project has been entirely financed through equity.
- **Peshawar Project:** This project comprises firstly installation of melting unit with an installed capacity of 140,000MT per annum and secondly BMR of re-rolling mill to enhance production capacity from 72,000MT to 120,000MT per annum.

  Installation of melting unit has been completed. Trial production of billets was conducted in November'2019, followed by full-scale production in May'2020 whereby around 11,000 MT of billets were produced monthly and transferred to re-rolling mill at Lahore as raw material for production of rebars. Newly installed melting unit is based on energy-efficient green furnace technology, with improved yield.

  BMR of re-rolling mill at Peshawar was expected to be completed in March'2020. The installation has been delayed, and as per the new timeline, delivery of machinery is expected in-August'2020 and COD is expected by end-October'2020. BMR and melt shop project cost amounted to Rs. 1.5b, out of which Rs. 450m has been financed through syndicated term finance facility while the rest is funded through internal sources.

- **Lahore Project Phase II:** This project comprises installation of melting unit at the Lahore mill to transform it into an integrated mill with billets capacity of 250,000MT per annum. Work on this project will commence after the completion of the aforementioned Peshawar project and is expected to be completed within six months after commencement. Capex for Phase II is estimated at Rs. 1.9b, out of which Rs. 200m has already been injected as equity to set-up grid station at the Lahore plant. Remaining Rs. 1.7b will be financed through debt financing, comprising a mix of commercial bank borrowings of Rs. 450m while Rs. 1.25b will be availed under the SBP's Temporary Economic Refinance Facility (TERF) scheme on which the fixed markup rate has recently been reduced to 5% per annum. As per the management, the company would avail TERF for a tenor of 10 years.

Growth in revenue impacted by the outbreak of COVID-19 during FY20: Revenues were recorded at Rs. 4.9b (FY19: Rs. 10.5b) during 1HFY20. Improvement in gross margin was during the period was led by commencement of in-house production of billets and cost efficiencies. Operating expenses were largely stable, while the company incurred higher finance cost on account of increased utilization of short-term borrowings and higher average interest rate. Accounting for taxation, net profit was recorded at Rs. 489m (FY19: Rs. 947m) with improved net margin of 9.9% during 1HFY20.

Growth in revenue impacted mainly by the outbreak of COVID-19 during FY20 as production was halted partially in March and totally in April 2020 on account of lockdown due to Covid-19. However, the company resumed production in early May 2020 and managed to sell higher volumes in both in May and June 2020. Going forward, the management is anticipating that construction industry relief package and further relief measures introduced in the budget 2020-21 will support demand for steel in FY21 and beyond.

Coverages remained adequate: Overall liquidity position of the company is considered adequate. In line with profits, funds from operations (FFO) amounted to Rs. 593m (FY19: Rs. 1.2b; FY18: Rs. 496m), though the annualized FFO-to-total debt ratio decreased to 0.38x (FY19: 0.59x; FY18: 0.29x) mainly on account of higher utilization of short-term financing. The debt service coverage ratio, though decreased, remained high at 7.2x (FY19: 8.3x; FY18: 29.7x). Current ratio increased marginally to 1.59x (FY19: 1.55x; FY18: 1.30x) as the impact of higher short-term borrowings was more than offset by increase in inventory and receivables.

Leverage indicators, though increased, remained manageable: Paid-up capital of the company stood at Rs. 2.0b (FY19: Rs. 2.0b; FY18: Rs. 1.4b). Increase in paid-up capital during FY19 was due to issuance of fully paid bonus shares of Rs. 600m. Core equity accumulated to Rs. 3.7b (FY19: Rs. 3.2b; FY18: Rs. 2.2b) at end-1HFY20 on the back of profit retention. Outstanding short-term borrowings stood higher at Rs. 2.6b (FY19: Rs. 1.7b; FY18: Rs. 1.6b) mainly to finance raw material for melting unit.

As of June 30, 2020, short-term borrowings amounted to Rs. 1.8b against total available limit of Rs. 4.0b. The company also has non-funded lines of Rs. 4.8b, out of which Rs. 1.9b were utilized. Long-term debt amounted to Rs. 507m, including syndicated term finance facility of Rs. 450m availed for BMR of re-rolling mill. The tenor of said facility is 7 years, inclusive of a grace period of 2 years from the first drawdown date, and carries markup rate of 3-month KIBOR plus 1.50% per annum. The first installment of principal was due in April'2020, however, the company has availed the SBP's COVID-19 relief whereby the principal amount has been deferred for 1 year. Gearing and debt leverage stood at manageable levels of 0.86x (FY19: 0.65x; FY18: 0.79x) and 1.01x (FY19: 0.83x; FY18: 1.09x) at end-1HFY20. Assuming sustained levels of profits and short-term borrowings as at end-1HFY20, the gearing is projected at around 0.94x as the company plans to mobilize new long-term debt of Rs. 1.7b for Phase II of Lahore Project.

Frontier Foundry Steel (Private) Limited — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY18**	**FY19**	**1HFY20**
Non-Current Assets	2,211	2,941	2,956
Receivables	1,162	1,909	2,114
Stock in Trade	497	213	1,469
Advances, Deposits & Prepayments	525	660	792
Store, Spares	12	64	75
Cash & Bank Balance	445	259	175
Total Assets	**4,852**	**6,047**	**7,581**
Trade & Other Payables	322	125	120
Short-Term Borrowings	1,605	1,693	2,623
Long-Term Borrowings *(Inc. current matur)*	114	371	507
Deferred Tax	242	246	251
Other Liabilities	114	204	185
Total Liabilities	2,393	2,626	3,680
Tier-1 Equity	**2,191**	**3,170**	**3,658**
Total Equity	2,459	3,421	3,901
Paid-up Capital	1,391	1,991	1,991
INCOME STATEMENT	**FY18**	**FY19**	**1HFY20**
Net Revenue	7,021	10,519	4,942
Gross Profit	757	1,556	790
Profit Before Tax	414	986	498
Profit After Tax	261	947	489
FFO	496	1,208	593
RATIO ANALYSIS	**FY18**	**FY19**	**1HFY20**
Gross Margin (%)	10.8	14.8	16.0
Net Margin (%)	3.7	9.0	9.9
Net Working Capital	603	1,100	1,721
Current Ratio (x)	1.30	1.55	1.59
FFO to Long-Term Debt (x)	4.33	3.26	2.34*
FFO to Total Debt (x)	0.29	0.59	0.38*
Debt Servicing Coverage Ratio (x)	29.7	8.3	7.2
ROAA (%)	7.0	17.4	14.3*
ROAE (%)	14.0	32.2	26.7*
Gearing (x)	0.79	0.65	0.86
Debt Leverage (x)	1.09	0.83	1.01

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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 — Annexure III

Name of Rated Entity	Frontier Foundry Steel (Private) Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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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Due Diligence Meetings Conducted	(see table below)

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
24/08/2020	A-	A-2	Positive	Maintained
11/05/2019	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Zarak Khan	CEO	June 8, 2020
Mr. Fayyaz Ahmad Jarral	CFO	June 8/ July 28, 2020