RATING REPORT

Frontier Foundry Steel (Private) Limited

REPORT DATE:
November 01, 2021

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A	A-1	A-	A-2
Rating Date	01st Nov'21		25th Aug'20	
Rating Outlook	Stable		Positive	

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 (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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 ('FF Steel' or 'the Company') deals in manufacturing of billets and reinforcement bars (rebars). The Company has a mid-sized capacity of rebars with plants located in Peshawar and Lahore.

Sector Update

- In tandem with pandemic-induced economic slowdown noted in H2'FY20, demand for steel & allied products was affected, as precipitated by the negative movement in LSM, which fell by 18% in H2'FY20, and revenue contraction experienced by almost all listed steel industry participants.

- However, during FY21, industrial operations picked up pace, as reflected by an uptick of 14.85% in the LSM index. With macroeconomic growth trajectory having a positive outlook, LSM growth is expected to remain elevated during the medium term horizon. Our positive demand outlook for steel is also supported by low per capita steel consumption vis-à-vis regional and global averages. The positive outlook for steel producers, along with low prevailing interest rates, are expected to support the steel industry's profitability

- With current macro-economic scenario, the steel demand will continue to improve in short to medium term. Broad factors that will support demand include government spending in development projects, CPEC related construction, Dams construction and Naya Pakistan Housing Scheme.

- During November 2020, steel bar prices were ranging between Rs. 110,000-113,000/MT, which rose to Rs 150,500/MT as at Jun'21. This increase in price was mainly precipitated by rising scrap prices globally and rupee depreciation. Given volatile pattern of scrap prices, the related business risk for steel industry is trended up. In addition, rising power cost and mis-declaration of imported scrap will continue to remain challenges for local industry.

Key Rating Drivers

Topline displayed noticeable growth as the company increased its capacity. Sales are forecasted to grow further on the back of increase in melting capacity and rise in long steel demand

- The Company's Peshawar plant came online in December 2020 with billets making capacity of 140,000 MTs, which initially supported the Lahore plant to increase its rebars production. In April 2021, the Peshawar plant rebars capacity also increased to 120,000 MTs from 72,000 MTs.

- The increase capacity has significantly increased the overall sales offtake of the Company, which in combination with higher rebar prices translated in strong growth in topline with overall net sales witnessed a surge of 1.6x during FY21.

- In addition to the growth in demand, FF Steel has introduced the concept of online sales to the industry. As of FY21, corporate customers remained the mainstay representing 45% of the offtake, followed by distributors at 35% of the offtake. In addition, the Company has generated strong growth in direct sales to households, representing a fifth of the sales offtake. The improving clientele diversification is viewed positively from a rating purview.

- The Company is in the process of adding 250,000 MTs of billet making capacity in its

Lahore plant. The project is underway is expected to be concluded by March 2022.

- Going forward, sales growth is projected to average 30% during the rating horizon.

- During FY21, the Company's business performance was underlined by strong growth in offtake, albeit, the margins were affected given the volatility in raw material costs. Nevertheless, the 1.6x growth in revenue base, translated in 1.3x growth in gross profit. Given lower prevailing interest rate during the period, the Company's effective finance cost was lower by ~230bpts. Accordingly net margin depicted slight improvement, while absolute profitability measures like RoAA & RoAE have depicted strong uptick.

P&L (Extract)	FY19	FY20	FY21
Sales	10,519	7,878	20,517
Gross Profit	8,963	6,825	18,107
Profit Before Tax	986	451	1,500
Profit After Tax	947	453	1,236
Gross Margin	*14.8%*	*13.4%*	*11.7%*
Net Margin	*9.0%*	*5.7%*	*6.0%*
ROAA	*17.4%*	*6.1%*	*10.0%*
ROAE	*32.2%*	*12.4%*	*19.4%*

Sound coverage indictors with adequate liquidity to meet obligations

- Given the growth in profitability, cash flow coverage indicators have posted notable improvement. As of endFY21, the Company's FFO to Debt stood at 0.43m, meaning that the Company can pay its entire debt from a little over 2 year's cash flow.

- The Company's DSCR slightly dropped to 4.2x. (FY20: 4.6x), as principal repayments increased. This is likely to remain under pressure as loan payments are accelerated in coming years. Nevertheless, it will continue to compare favorably to peers.

- On the other hand, the cash conversion cycle has notable contracted from ~200days to less than ~90days.

	FY19	FY20	FY21
FFO (Mn.)	1,208	697	1,676
DSCR (x)	8.03	4.63	4.17
FFO to Debt	0.59	0.17	0.43
Working Capital (Mn.)	1,100	1,330	2,442
Current Ratio (x)	1.55	1.31	1.52
Cash (Mn.)	259	477	289

Manageable leveraging with equity growing on a sustainable pace

- Equity (excluding revaluation surplus) of the company has grown at a CAGR of 31% since FY18. The growth in equity came from strong profitability and absence of any payout to shareholders during this period.

- Despite ongoing expansion, leverage remained intact as at Jun'21 while gearing ratio depicted a marginal decline in line with repayment of long term loans.

- Overall capitalization indicators including debt and equity remained manageable during the period under review.

- Going forward, the borrowings are expected to increase while equity will also continue to depict strong growth as payout is projected to remain nil. The gearing ratio is likely to depict marginal increase as of Jun'22, albeit will subsequently drop.

Balance Sheet (Extract)	FY19	FY20	FY21
Current Assets	3,105	5,629	7,162
Total Assets	6,047	8,896	15,900
LT Borrowings	371	556	540
ST Borrowings	1,693	3,434	3,356
Total Liabilities	2,626	5,024	7,050
Equity	3,170	3,639	4,971
Gearing (x)	*0.65*	*1.10*	*0.78*
Leverage (x)	*0.83*	*1.38*	*1.42*

Corporate Governance has room for improvement

- Given the Company's status as a private limited company, Corporate Governance (CG) lags similar rated listed counterparts. However, with an IPO planned in the near future, improvement in remains on forefront of management agenda.

- At present, Board structure lacks sub-committees, which could add to Board supervisory oversight.

Frontier Foundry Steel (Private) Limited — Annexure I

FINANCIAL SUMMARY (amounts in PKR millions)		(Appendix I)	
BALANCE SHEET	**FY19**	**FY20**	**FY21**
Non-Current Assets	2,941	3,267	8,738
Receivables	1,909	1,343	1,859
Stock in Trade	213	2,726	3,236
Advances, Deposits & Prepayments	660	976	1,636
Store, Spares	64	108	142
Cash & Bank Balance	259	477	289
Total Assets	6,047	8,896	15,900
Trade & Other Payables	125	425	814
Short-Term Borrowings	1,693	3,434	3,356
Long-Term Borrowings (Inc. current maturity)	371	556	540
Deferred Tax	246	231	1,965
Other Liabilities	192	378	377
Total Liabilities	2,626	5,024	7,050
Total Equity (Exc. Reval. Surplus)	3,170	3,639	4,971
Paid-up Capital	1,991	2,891	3,631
INCOME STATEMENT	**FY19**	**FY20**	**FY21**
Net Revenue	10,519	7,878	20,517
Gross Profit	1,556	1,053	2,409
Profit Before Tax	986	451	1,500
Profit After Tax	947	453	1,236
FFO	1,208	697	1,676
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**
Gross Margin (%)	14.8%	13.4%	11.7%
Net Margin (%)	9.0%	5.7%	6.0%
Net Working Capital	1,100	1,330	2,442
Current Ratio (x)	1.55	1.31	1.52
FFO to Long-Term Debt (x)	3.26	1.26	3.11
FFO to Total Debt (x)	0.59	0.17	0.43
Debt Servicing Coverage Ratio (x)	8.03	4.63	4.17
ROAA (%)	17.4%	6.1%	10.0%
ROAE (%)	32.2%	12.4%	19.4%
Gearing (x)	0.65	1.10	0.78
Debt Leverage (x)	0.83	1.38	1.42

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	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	01/11/2021	A	A-1	Stable	Upgrade
	24/08/2020	A-	A-2	Positive	Maintained
	11/05/2019	A-	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.				
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Due Diligence Meetings Conducted	**Name**	**Designation**	**Date**		
	Mr. Fayyaz Ahmad Jarral	CFO	September 13, 2021		