RATING REPORT

Frontier Foundry Steel Limited

REPORT DATE:
July 24, 2024

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-1	A	A-1
Rating Date	*July 24, 2024*		*June 22, 2023*	
Outlook/ Rating Watch	Stable		Stable	
Rating Action	Reaffirmed		Maintained	

COMPANY INFORMATION	
Incorporated in 1986	**External auditors:** Yousuf Adil Chartered Accountants
Public Unlisted Limited Company	**Chairman of the Board:** Mr. Nauman Wazir Khattak
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Zarak Khan
Zarak Khan ~80.2%	
Nauman Wazir Khattak ~16.5%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates https://docs.vis.com.pk/docs/CorporateMethodology.pdf

RATING SCALE(S)
VIS Issue/Issuer Rating Scale: https://docs.vis.com.pk/docs/VISRatingScales.pdf

Frontier Foundry Steel Limited

OVERVIEW OF THE INSTITUTION

Frontier Foundry Steel (Private) Limited (FSL) has been incorporated in Pakistan as a private limited company since 1986. Subsequent to the year end, on 8 September 2023, the legal status of the Company has been changed from private limited company to public unlisted company. The principal activity of the Company is manufacturing and sale of steel bars and copper ingots with the production units 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

RATING RATIONALE

Corporate Profile

Frontier Foundry Steel Limited ('FFSL' or 'the Company') has been incorporated in Pakistan as a private limited company since 1986. Subsequent to the year end, on 8 September 2023, the legal status of the Company has been changed from private limited company to public unlisted limited company. The principal activity of FFSL is manufacturing and sale of steel bars. The Company also operates copper extraction and ingot casting facilities as auxiliary business.

The registered office of the Company is situated at 4-B, Sir Syed Road, Peshawar Cantt, Pakistan. The Company has two production plants for steel bar, one is situated at Plot # 166, Road B-7 Hayat Abad Industrial Estate, Peshawar, Pakistan and the other at Muhib Stop, 7 KM Manga Raiwind Road, Manga Mandi, Lahore. The Company has also one export-oriented production unit of copper ingots situated at Godown No. 4, Moza Rehman Chowk, Kacha Kialli, Gujranwala.

Key rating drivers

High business risk profile is characterized by heightened exposure to supply chain disruptions, intense competition and exchange rate risk.

VIS categorizes the long steel industry's business risk profile as high. The industry's performance was marred by major supply chain disruptions due to the Russia-Ukraine War, surging inflation, the depreciation of the local currency and depleting foreign exchange reserves in FY23. Moreover, the long steel sector in Pakistan is highly fragmented and intensely competitive, hosting more than 300 melting and re-rolling mills mostly in unorganized sector. However, only a handful of companies are considered top-tier players. Additionally, the sector is considered to be highly cyclical with demand dependent upon the level of construction activity in the country and expenditure on public sector development programs.

The long steel industry is a sub-segment of 'Iron & Steel Products' group within the large-scale manufacturing sector, accounting for ~3.5% of the Large-Scale Manufacturing (LSM) sub-segment of the economy. As the demand for steel is derived from various industries like construction, automotive, and appliances, economic downturn in these industries due to multiple factors like poor economic conditions, rupee depreciation and rising inflation has greatly contributed to the decline in demand for steel.

Although there is a slight hint of stability observed in the macroeconomic conditions in FY24, persistent issues such as high energy costs, inflation, and high interest rates will continue to pose as significant hurdles to the industry's growth prospects going forward.

Topline improved, supported by an increase in prices. Inventory gains resulted in increased gross margins in FY23.

In FY23, the Company's revenue increased by 25%, driven by an increase in selling prices, while volumes remained constrained and actual production declined by 7.4%. FFSL transferred increased *his bachelor's degree for his academic achievement.*

input costs, including rising fuel costs, PKR depreciation-related raw material cost escalation and other operating costs to its customers, mitigating the impact of the volumetric decline. Due to restricted imports and limited availability of letter of credit lines, FFSL utilized its existing inventory, procured at lower costs resulting in inventory gains. This led to an improvement in the Company's gross margins in FY23 to 11.99% (FY22: 9.95%). However, net margins declined to 4.0% (FY22: 4.8%) in FY23, primarily due to increased finance costs resulting from an 825-basis point surge in the policy rate. During 9MFY24, gross margins normalized to 9.89%, similar to FY22 levels. Pressure on net margins remained consistent, further declining to 1.8% during the period as the policy rate remained elevated.

Adequate liquidity profile. However, increase in the cash conversion cycle noted with higher days to collect receivables

The liquidity profile of the Company is considered adequate, with a three-year average current ratio of 1.5x. The current ratio remained stable at 1.50x in 9MFY24 (FY23: 1.52x, FY22: 1.53x). During FY23, the cash conversion cycle (CCC) increased to 101 days (FY22: 72 days) due to a longer collection period. This trend continued in 9MFY24, with the CCC rising to 108 days. The collection period has increased due to the higher composition of institutional sales than compared to retail sales during FY23 and 9MFY24.

On a timeline basis gearing and leverage depict a rising trend.

With increased CCC the Company had to bridge the widening working capital gap through short-term borrowings. This resulted in the Company's gearing ratio to slightly heightening to 1.28x (FY22: 1.11x). However, leverage only slightly increased to 1.70x (FY22: 1.65x), much of the impact of higher debt on leverage ratio was offset by decline in payables during the period. This trend continued in 9MFY24 with short-term drawdowns further increasing, resulting in gearing and leverage metrics rising to 1.37x and 1.68x, respectively.

Coverage profile reported significant erosion but remained at adequate levels.

As a result of higher short-term debt drawdowns, and resultant increase in financial burden, the debt service coverage ratio (DSCR) eroded to 1.44x (FY23: 1.67x, FY22: 3.31x), albeit remaining at adequate levels. FFSL's short-term debt coverage also remained adequate, despite decreasing to 1.47x (FY22: 1.60x) in FY23. The short-term debt coverage, however, remained stable at 1.48x in 9MFY24.

<u>Considerations for Future Reviews</u>

Going forward, key business and financial risk indicators include the Company's ability to maintain its topline and margins amidst economic challenges and high energy costs. Management's plans to stabilize and improve systems and controls, manage capitalization metrics, and ensure adequate liquidity will be critical. The Company's ability to address the prolonged cash conversion cycle and maintain adequate coverage metrics will be vital for sustaining assigned ratings.

REGULATORY DISCLOSURES — Annexure I

Name of Rated Entity	Frontier Foundry Steel 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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Rating History

Rating Date	Medium to Long Term	Short Term	Outlook/Rating Watch	Rating Action
RATING TYPE: ENTITY				
07/24/2024	A	A-1	Stable	Reaffirmed
06/22/2023	A	A-1	Stable	Maintained
03/31/2023	A	A-1	RW- Dev	Maintained
02/22/2023	A	A-1	Stable	Reaffirmed
01/11/2021	A	A-1	Stable	Upgrade
24/08/2020	A-	A-2	Positive	Maintained
11/05/2019	A-	A-2	Stable	Initial

Due Diligence Meeting Conducted

Name	Designation	Date
Mr. Rizwan Alam Dhillon	GM – Capital Market	July 11, 2024