RATING REPORT

Razaque Steels (Private) Limited

REPORT DATE:
November 19, 2018

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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB-	A-3
Rating Date	November 19, 2018	
Rating Outlook	Stable	
Rating Action	Initial	

COMPANY INFORMATION	
Incorporated in 1963	**External auditors:** BDO Ebrahim & Co. Chartered Accountants
Private Limited Company	**Managing Director (MD):** Mr. Irshad Mowjee
Key Shareholders (with stake 5% or more):	
Mr. Irshad Mowjee – 50%	
Ms. Farhana Mowjee – 50%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016) http://www.jcrvis.com.pk/kc-meth.aspx

Razaque Steels (Private) Limited

OVERVIEW OF THE INSTITUTION

Razaque Steels (Private) Limited (RSPL) was incorporated on 18th July 1963 as a Private Limited Company under the Companies Ordinance 1984. The company is primarily engaged in the manufacturing and sale of steel bars and billets with its registered head office based in Karachi, Pakistan.

Directors' Profile
Mr. Irshad Mowjee has been associated with the family business as the Managing Director and possesses relevant experience of more than 30 years. He is a B.A (Hons) in Economics from City of London Polytechnic and also holds MBA degree from Imperial College, University of London.

Ms. Farhana Mowjee is the Director and has been associated with the company since 1991. Prior to joining RSPL; she has served as a Manager in Ernst and Young (UK). She holds a Bachelors of Arts (Hons) in Philosophy from University College London. She also completed her Chartered Accountancy Training and Qualification in 1988 in UK.

Financial Snapshot
Equity: June'2018: Rs. 561.3m, June'2017: Rs. 458.0m

Net Revenue: FY18: Rs.3.2b, FY17: Rs.1.9b

RATING RATIONALE

Incorporated as a private limited company in 1963, Razaque Steels (Private) Limited (RSPL) is involved in the manufacture and sale of billets and steel bars, catering primarily to institutional clients. Shareholding of the company is vested with the Mowjee family. Management team is being spearheaded by Mr. Irshad Mowjee who is supported by his sister Ms. Farhana Mowjee. The company has two production facilities 'Unit A' and 'Unit B' located at S.I.T.E-Karachi and Hub-Balochistan, respectively.

Unit A - (Rerolling mill) has a capacity to manufacture 32,000MT per annum of reinforcement bars (rebars). Management plans to enhance capacity to 40,000 MT by FY20 through upgradation and modification in existing plant and machinery.

Unit B – comprises a billet manufacturing facility with an installed capacity of 50,000MT per annum. This facility was acquired from Faizan Steel Group (Amaan Steels) during FY18 on a long term operating lease to cater to RSPL's raw material needs while any surplus quantum produced is expected to be sold in the local market.

RSPL's capacity utilization level of bars and billets stood at 97% (FY17: 89%) and 85.3%, respectively during FY18.

<u>Rating Drivers</u>

Healthy long-term demand growth outlook and significant duty protection for local players is expected to partly mitigate overall high sectoral risk borne by the long steel sector given fragmented, cyclical, and competitive nature of the industry
Overall sectoral risk is considered high given the fragmented and cyclical nature of industry, expected increase in competition post capacity expansion by established existing and new players and significant reliance on duty protection. However, outlook for the sector has witnessed improvement on the back of healthy demand due to investment in development of infrastructure & power generation and increase in duty protection against imports from China. Local players enjoy ~ 39% (RD of 15%; ADD of 24%) and ~ 49.5% (RD of 30%, ADD of 19.15%) duty protection on imported billets and rebars, respectively, and thus resulting in improved pricing power of industry players. The industry's business risk profile is vulnerable to any adverse change in the duty structure. Post expansion, top-tier integrated players (undergoing capacity expansion) will benefit from significantly lower cost of production vis-à-vis smaller non-integrated players and therefore will be relatively better positioned. Going forward, JCR-VIS expects demand growth to slow down in the short-term in line with slower economic growth in the backdrop of increasing interest rates and sizeable current account deficit. However, demand outlook over the medium to long-term is expected to remain healthy given focus of the government on construction of dams and housing sector.

Sales growth driven by an upward trend in volumes and average selling prices
Over the past three fiscal years (FY15-18), RSPL's net sales have increased at a Compound Annual Growth Rate (CAGR) of 8.02%. During outgoing year FY18, net sales were reported at Rs. 3.2b (FY17: Rs. 1.9b) demonstrating a year-on-year growth of 61.6%. Increase in sales is primarily a function of higher average sales price while growth in volumes also contributed to revenue increase. Going forward, as per management, the same is expected to grow further with gradual increase in installed capacity and higher average selling prices.

Gross margins compare unfavorably to industry peers; however, going forward the same are projected to improve given the benefits arising from commencement of operations of backward integrated facility and projected growth in sales volumes
The company reported gross margins of 6.5% (FY17: 6.3%) which compare unfavorably to industry peers. Lower margins are on account of non-integrated business operations translating into higher transportation and re-heating costs given the distance between melting and re-rolling units. Additionally, given load constraints, the company's melting unit requires longer heating time resulting in higher power costs. However, with expected decline in average per unit cost of raw material on the

back of backward integration of operations, projected higher sales volumes and favorable selling prices, margins are projected to improve going forward. Accounting for a one-off provisioning reversal, the company posted a profit after tax of Rs. 103.3m (FY17: Rs. 42.3m) during FY18. Higher sales revenue and margins are expected to offset the impact of increase in finance cost due to growing working capital requirements and rising interest rates.

Leverage indicators on the higher side due to extensive working capital requirements and low equity base. Overall capitalization assessment supported by low dividend payouts and limited debt for funding capital expenditure

Capitalization levels have improved over the years through profit retention with equity base of the company increasing at a 3-yr CAGR of 16%.With backward integration of business operations, working capital cycle of the company necessitates higher utilization of short term borrowings. Debt profile of the company is short term in nature with total debt amounting to Rs. 1.03b (FY17: Rs. 126m) at end-FY18. Increase in borrowings is a function of higher working capital requirements. Resultantly, leverage and gearing ratios have increased to 2.42x (FY17: 0.91x) and 1.85x (FY17: 0.28x) respectively. Dividend payouts have historically remained limited and management does not plan to mobilize long-term borrowing to fund expansion.

Adequate liquidity profile

Liquidity profile of the company is considered adequate in view of sufficient cash flows in relation to outstanding obligations, satisfactory debt servicing, and aging of trade debts which remains with in manageable levels. In absolute terms, RSPL's funds flow from operations (FFO) has increased significantly to Rs. 132m (FY17: Rs. 46m) on the back of higher net profitability. However, with increase in short term borrowing to fund working capital requirements, FFO to total debt depicted a noticeable decline to 13% (FY17: 37%). Current ratio was reported at 1.22x (FY17: 1.67x; FY15: 1.52x) at end-FY18.

Corporate governance framework has room for improvement

Overall board structure and oversight has room for improvement through induction of independent directors, greater discussion on future strategy along with improvisation in internal control framework of the organization. Development and documentation of a formal succession plan is also considered important.

Razaque Steels (Private) Limited **Appendix I**

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY15**	**FY16**	**FY17**	**FY18**
Fixed Assets	257.1	282.8	349.2	517.4
Stock-in-Trade	251.2	458.2	254.8	838.8
Trade Debts	318.9	295.2	264.5	421.0
Cash & Bank Balances	54.1	1.1	1.2	5.2
Total Assets	955.5	1,200.4	1,088.1	2,215.3
Trade and Other Payables	285.2	342.4	285.6	315.4
Long Term Debt	-	-	-	-
Short Term Debt	132.9	252.5	126.2	1,037.0
Total Debt	132.9	252.5	126.2	1,037.0
Total Equity	363.2	435.7	458.0	561.3
INCOME STATEMENT				
Net Sales	2,557.8	2,443.4	1,995.4	3,224.0
Gross Profit	137.6	120.1	125.9	209.2
Profit Before Tax	65.4	128.5	70.1	146.9
Profit After Tax	35.7	72.5	42.3	103.3
RATIO ANALYSIS				
Gross Margin (%)	5.4%	4.9%	6.3%	6.5%
Net Margin	1.4%	3.0%	2.1%	3.2%
Net Working Capital	270.2	310.2	277.6	295.7
Trade debts/Sales	12.5%	12.1%	13.3%	13.1%
FFO	1.0	41.5	46.2	131.8
FFO to Total Debt (%)	0.7%	16.4%	36.6%	12.7%
FFO to Long Term Debt (%)	NA	NA	NA	NA
Current Ratio (x)	1.64	1.52	1.67	1.22
Debt Servicing Coverage Ratio (x)	1.03	2.87	4.34	3.67
Gearing (x)	0.37	0.58	0.28	1.85
ROAA (%)	3.7%	6.7%	3.7%	6.3%
ROAE (%)	9.8%	18.2%	9.5%	20.3%

ISSUE/ISSUER RATING SCALE & DEFINITION — Appendix II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Razaque Steels (Private) Limited
Sector	Steel Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
Nov'19 2018	BBB-	A-3	Stable	Initial