RATING REPORT

Razaque Steels (Private) Limited

REPORT DATE:
March 09, 2020

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	BBB-/A-3	BBB-/A-3
Rating Date	*March 09, 2020*	*November 19, 2018*
Rating Outlook	*Stable*	*Stable*

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%	
Mr. Farhana Mowjee – 50%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (April, 2019) **https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf**

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 since 2006. 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 40,000MTs per annum of reinforcement bars (rebars).

Unit B – 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.

<u>Rating Drivers</u>

Amidst the prevailing macroeconomic slowdown, off-take from long steel manufactures has suffered. Product pricing has risen, given cost push inflation and higher cost of financing.

In tandem with our outlook, steel sector off-take has been affected, given demand slowdown in its most pertinent downstream industry i.e. the construction sector. During 1H'FY20 the long steel sector contracted by 26%, while the flat steel sector contracted by 1%. Furthermore, taking steel imports as a proxy for steel industry demand – given that Pakistan meets about 30-40% of its demand through import – volumetric import of steel scrap and steel products was lower by 20% and 31% during 1H'FY20.

Given demand contraction and margin shrinkage – precipitated by the cost-push inflation –several players in the long steel sector, particularly the ones that had undertaken sizable capacity additions in prior years, are facing capacity utilization issues. Future demand outlook remains depressed, in the absence of several planned public sector projects, and general slowdown in construction sector. Resumption of public sector projects, like the 'Naya Pakistan Housing Scheme' among others, will auger well for long steel demand.

Uptick in top line mainly driven by price increases, as volumetric off-take has shrunk

The company's topline can be categorized into two products i.e. Deformed Bars' (DBs) and 'Billets', with the latter being a semi-finished product that sold to other long steel producers for conversion to bars. DBs make up bulk of the company's gross sales, comprising 88%, while the remaining is contributed by billet sales. During FY19, RSPL's top line grew by 22% to Rs. 3.9b (FY18: Rs. 3.2b). The uptick was mainly attributable to the 17% pricing increase in DBs, while actual quantity sold dropped by 9%.

In 1H'FY20, RSPL recorded sales of Rs. 2.3bn. In quantitative terms, the sales was higher by 9% vis-à-vis SPLY.

Gross margins have been affected on account of rising cost of production. Furthermore profitability has been impacted by higher cost of financing.

In view of the rising inflation, and higher power costs, the production cost per MT has certainly increased. Despite low production, the fuel & power costs were higher by 6%, while cost of production (excl. fuel & power) was higher by 34%. In line with higher market prices, the selling price was also enhanced. Nevertheless, gross margins have taken a hit, reducing from 6.3% to 4.5%.

Cognizant of the pressure on profitability, the administrative overheads were reduced by 5%, which was not adequate enough to arrest the fall in operating margin (FY19: 8.9%; FY20: 2.8%). Furthermore, higher reliance on borrowings and a higher cost of borrowings – given a 575 bpts increase in benchmark rates during FY19 – the company posted a pre-tax loss of Rs. 3.5m vis-à-vis pre-tax profit of Rs. 238m in FY18. The net margin of company has dropped to -0.2% (FY18: 5.1%).

In 1HFY20, given the increase in pricing, the gross margins were relatively better at 7.0%.However, given higher reliance on short term borrowings and higher prevailing average benchmark rates in the ongoing year, finance cost was on the higher side. As a result operating margin was recorded at 0.6%, significantly lower than operating margin of 2.3% had the finance cost remained in tandem with prior year.

Working capital cycle has increased, which has impacted the company's FFO

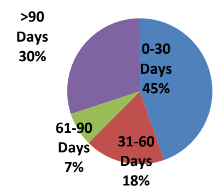
RSPL has facing the issue of delayed payments from customers, which has affected the company's working capital cycle and the FFO (FY19: Rs. 14m; FY18: Rs. 89m). Given the continuing uptick in trade debts, the company's cash conversion cycle has elongated.

Table 1: Cash Conversion Cvcle

	2018	2019	1H'FY20
DIO	100.5	82.3	71.5
DSO	47.7	63.9	86.0
DPO	24.1	18.4	28.3
CCC	**124.1**	**127.9**	**129.2**

As of Dec'19, the company's trade debts amounted to Rs. 1.1b, which represents roughly a third of the company's asset base. Of this, 30 (Rs. 334m) was outstanding for a period of more than 90 days, constituting about 42% of the company's adjusted equity.

Figure 1: Aging of Trade Debts



It is pertinent to mention that ~70% of the trade debts pertain to energy-related CPEC projects in Thar, wherein contractors are facing the issue of circular debt in addition to project delays. Amount outstanding against these contractors also comprises ~80% of the par-90 debt.

Debt utilization has increased. Amidst depressed profitability, this has translated in higher leverage

Table 2: Capitalization

	Jun'18	Jun'19	Dec'19
Leverage	1.91	1.72	2.51
Gearing	1.54	1.44	2.03

Given depressed profitability, the company's equity base has not depicted much improvement. Consequently, the increased debt utilization has increased the gearing and leverage. Besides increased debt utilization, the loan from sponsor was increased from Rs. 38m to Rs. 193m in FY19 and further to Rs. 204m in 1H'FY20. Given that the loan from sponsor is interest-free, with no fixed terms for repayment, we have incorporated the same as equity, while long term investment in associate has been deducted from equity. Cognizant of the depressed profitability, dividend payout has been mained at nil. At present, RSPL's adjusted gearing & leveraging remain within the threshold for the assigned rating. Nevertheless, the rising working capital requirements are a source of concern, as the same may continue to translate in further increase in gearing.

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

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**1HFY20**
Property, Plant & Equipment	349.2	588.2	629.5	649.4
Stock-in-Trade	254.8	831.7	850.2	850.7
Trade Debts	264.5	420.9	690.4	1,101.1
Cash & Bank Balances	1.2	5.2	3.5	3.0
Total Assets	1,088.1	2,267.1	2,552.9	3,142.7
Trade and Other Payables	285.6	199.5	189.6	336.6
Long Term Debt	-	-	-	-
Short Term Debt	126.2	998.5	1,150.4	1,593.9
Short Term Loan from Sponsor (Interest Free)	-	38.5	193.5	204.5
Total Debt	126.2	998.5	1,150.4	1,593.9
Paid up Capital	20	20	20	20
Adjusted Equity (incl. sponsor loan; excl. loan to associate)	443.5	647.8	796.5	786.8
INCOME STATEMENT				
Net Sales	1,995.4	3,223.9	3,944.7	2,335.6
Gross Profit	125.9	209.2	176.1	164.6
Profit Before Tax	70.1	238.1	(3.5)	14.4
Profit After Tax	42.3	165.8	(6.1)	(20.7)
RATIO ANALYSIS				
Gross Margin (%)	6.3%	6.5%	4.5%	7.0%
Net Margin	2.1%	3.2%	(0.2%)	(0.9%)
Net Working Capital	277.6	338.8	84.2	34.1
Trade debts/Sales	13.3%	13.1%	17.5%	23.6%*
FFO	46.2	88.7	14.4	NA
FFO to Total Debt (%)	36.6%	8.9%	1.3%	NA
FFO to Long Term Debt (%)	NA	NA	NA	NA
Current Ratio (x)	1.67	1.34	1.34	1.23
Debt Servicing Coverage Ratio (x)	4.34	2.80x	1.13x	NA
Leverage (x)	0.94	1.91	1.72	2.51
Gearing (x)	0.28	1.54	1.44	2.03
ROAA (%)	3.7%	9.9%	(0.3%)	(1.5%)*
ROAE (%)	9.5%	30.7%	(1.0%)	(5.1%)*
*Annualized				

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

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
03/09/2020	BBB-	A-3	Stable	Reaffirmed
11/19/2018	BBB-	A-3	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. Irshad Mowjee	Director	February 26, 2020
Mr. Aziz	CFO	February 26, 2020